

# The Lawyer - Economist at Chicago: Richard A. Posner and the *Economic Analysis of Law*

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## INTRODUCTION

There was a time when law students were taught to approach the study of law with the perspective of a natural scientist. In the tradition established by Christopher Columbus Langdell at Harvard Law School in the 1870s, law was conceived to be a "science" consisting of fundamental "principles or doctrines" that could be discovered by examining a relatively small number of appellate decisions.<sup>1</sup> In Langdell's view, law students could learn to discover the fundamental unity of the law by the inductive process of analyzing separate cases. In quest of a scientific approach to legal education, Langdell replaced the textbook and lecture with the casebook and case method of instruction and devoted the entire study of law to the methodical search for universal and immutable principles. In revolutionizing the study and teaching of law, Langdell "inaugurated not merely a new method of teaching, but a new mode of envisaging American law."<sup>2</sup>

While the case method of instruction has survived as a professionally relevant pedagogical tool, Langdell's conception of law seems to be dead.<sup>3</sup>

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1. Langdell stated his basic premises as follows:

[First] that law is a science, and [second] that all the available materials of that science are contained in printed books. . . .

. . . [T]he library . . . is to us all that the laboratories of the university are to the chemists and physicists, the museum of natural history to the zoologists, the botanical garden to the botanists.

Langdell, *Harvard Celebration Speech*, 3 L.Q. REV. 123, 124 (1887). See also C. LANGDELL, *Preface to SELECTION OF CASES ON THE LAW OF CONTRACTS* (1879). For a review and critical analysis of Langdell's basic assumptions, see Holmes, *Education for Competent Lawyering—Case Method in a Functional Context*, 76 COLUM. L. REV. 535, 542-60 (1976). See generally Ackerman, *Introduction: On the Role of Economic Analysis in Property Law*, in *ECONOMIC FOUNDATION OF PROPERTY LAW* (B. Ackerman ed. 1975).

2. H. REED, *TRAINING FOR THE PUBLIC PROFESSION OF THE LAW* 378 (1921). Langdell's case method was viewed as a "return to the principles of legal education demanded by the very nature of the common law." J. REDLICH, *THE COMMON LAW AND THE CASE METHOD IN AMERICAN UNIVERSITY LAW SCHOOLS* 37 (1914).

3. See, e.g., Holmes, *supra* note 1, at 555-56. But see note 8 and accompanying text *infra*. Langdell's conception of law as an absolute system of principles was initially put to rest by the skepticism of the legal realists, see, e.g., Frank, *A Plea for Lawyer-Schools*, 56 YALE L.J. 1303 (1947), and the subsequent movement toward a "secularized" approach to law study, see, e.g., Woodward, *The Limits of Legal Realism: An Historical Perspective*, 54 VA. L. REV. 689, 690-91 (1968).

The idea of law as a universal body of scientifically discoverable principles appears absurd to modern legal educators who see law as "process, flux, change."<sup>4</sup> As Professors Packer and Ehrlich have recently observed: "[L]aw is now recognized by most teachers of law to be a multidimensional phenomenon—historical, philosophic, psychological, social, political, economic and religious."<sup>5</sup> In their view law is not a science; it is a process for administering and harmonizing the multitude of conflicting interests within society.<sup>6</sup> When viewed as process, law lacks a fundamental unity that can be discovered in the Langdellian sense. Some ideas, however, never die. Instead, they merely reappear in a slightly different dress. Richard A. Posner's *Economic Analysis of Law*<sup>7</sup> is an example.

With the publication of the second edition of *Economic Analysis of Law*, Posner has refined and polished a modern version of the Langdellian idea that law consists of a rational and universal system of scientifically discoverable principles or doctrines.<sup>8</sup> The central theme of Posner's book is that the common law consists of a fundamental unity and that the "basic characteristics" of the legal order can be discovered by applying the critical analysis of economics. The seemingly unrelated subjects of contract, property, tort, and criminal law are analyzed in the belief that the common law consists of fundamental principles that are economic in derivation. The differences between these substantive legal categories are seen as "primarily differences in vocabulary, detail, and specific subject matter

4. Holmes, *supra* note 1, at 556. Holmes points out that "[r]any such law teachers are pragmatic in the social utility sense, rely heavily on experience as the chief source of wisdom, are guided by social science theories of evolution in social affairs, and proclaim relativity in customs, morals and law." *Id.*

5. H. PACKER & I. EHRLICH, *NEW DIRECTIONS IN LEGAL EDUCATION* 56 (1972).

6. *Id.* at 56-58; see also Rosenberg, *The New Looks in Law*, 52 MARQ. L. REV. 539 (1969-70). Law as process is a central theme of Professor Alfred Conard's concept of "macrojustice." Conard, *Macrojustice: A Systematic Approach to Conflict Resolution*, 5 GEORGIA L. REV. 415 (1971). Macrojustice seeks to analyze law as a system or process in which the emphasis is placed on problems of justice *qua* system (macrojustice) rather than justice *qua* individual (microjustice). The distinction between macrojustice and microjustice is analogous to that between macroeconomics, which is concerned with aggregate problems of national income, inflation and employment, and microeconomics, which is concerned with the activities of individual economic agents within the market system. The macrojustice approach to legal education has shifted emphasis from principles to a process whereby the study and teaching of law is viewed from a functional context. See Holmes *supra* note 1, at 537.

7. R. POSNER, *ECONOMIC ANALYSIS OF LAW* (1972) [hereinafter cited as *ECONOMIC ANALYSIS I*]; R. POSNER, *ECONOMIC ANALYSIS OF LAW* (2d ed. 1977) [hereinafter cited as *ECONOMIC ANALYSIS II*].

8. In his 1974 Storrs Lectures on Jurisprudence, Professor Grant Gilmore cites Posner's *Economic Analysis of Law* as an example of the "New Conceptualism" in legal scholarship that Professor Gilmore views as a return to the unitary theories of Langdell. G. GILMORE, *THE AGES OF AMERICAN LAW* 108 n.11 (1977). In noting this same development, Professor Arthur Leff concludes that Posner's book represents "a new basic academic theory of law," which Leff has entitled "American Legal Nominalism." As Professor Leff explains:

We are, I think, beginning to see in the speedy spread of economic analysis of law the development of a new basic academic theory of law. Since its basic intellectual technique is the substitution of definitions for both normative and empirical propositions, I would call it American Legal Nominalism.

Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451, 459 (1974). See also note 10 *infra*.

rather than in method or policy."<sup>9</sup> In keeping with the basic tenet of the Langdellian faith, Posner claims that "it may be possible to deduce the basic formal characteristics of law itself from economic theory."<sup>10</sup>

There are, of course, significant differences in the Posnerian and Langdellian approaches to the study of law. Whereas Langdell replaced the textbook method of teaching with the case method, Posner has reversed the process by utilizing the textbook approach. *Economic Analysis of Law* is "mainly designed for use either as a textbook in a law school course in economic analysis of law or as supplementary reading for law students who are interested in finding out what economics may have to add to their understanding of the legal process."<sup>11</sup> While Langdell believed that law students could learn to discover fundamental principles by the inductive process of analyzing cases, Posner believes that students can learn to deduce unifying characteristics by applying economic analysis to legal problems. While the student trained in the Langdellian tradition was taught to approach law with the perspective of the natural scientist, the Posnerian student is cast in the role of the economist. Despite these differences in pedagogical approach, both Langdell and Posner share the common belief that law students can learn to discover fundamental principles in a logical and rational manner. To that extent, both conceive the study of law to be a search for fundamental unity.

In claiming that it may be possible to deduce legal principles from economic theory, Posner has presented an attractive argument for considering an economic approach to the study and teaching of law. The justification for the use of economics in legal education is that it may permit students to study legal doctrine in a more "analytical spirit" than is permitted by traditional law school pedagogy.<sup>12</sup> The underlying belief is that an economic perspective can "teach more legal doctrine than the

9. ECONOMIC ANALYSIS II, *supra* note 7, at 179.

10. *Id.* at 189. In support of his conclusion that Posner's book represents a return to the conceptualism of Langdell, Professor Gilmore points to an editorial *Afterword* that Posner wrote for the *Journal of Legal Studies*, which Posner has edited since 1972. G. GILMORE, *supra* note 8, at 108 n.11. There, the parallelism with Langdell's basic premise is unmistakably clear. As Posner expressed the idea in the *Afterword*:

The aim of the *Journal* is to encourage the application of scientific methods to the study of the legal system. As biology is to the living organisms, astronomy to the stars, or economics to the price system, so should legal studies be to the legal system: an endeavor to make precise, objective, and systematic observations of how the legal system operates in fact and to discover and explain the recurrent patterns in the observations—the "laws" of the system. Although much pioneering work of high distinction has been done, it is plain that our subject is in its prescientific stage.

I J. LEGAL STUD. 437 (1972). This view is remarkably similar to the ideas expressed in Langdell's Harvard address, *supra* note 1. See also Leff, *Law and*, 87 YALE L.J. 989, 1005-08 (1978).

11. ECONOMIC ANALYSIS II, *supra* note 7, at xxiii (footnote omitted). Posner has reprinted the *Preface* to the first edition at xxi-xxiii of the second edition. The comments made therein are equally applicable to either edition of *Economic Analysis of Law*.

12. See, e.g., Ackerman, *supra* note 1, at vii-x. See also ECONOMIC ANALYSIS II, *supra* note 7, at 18.

current course in which so much time is devoted to the aimless study of bits of history and 'relevant' cases."<sup>13</sup> This Comment will evaluate the second edition of Posner's *Economic Analysis of Law* in light of these claims.<sup>14</sup>

The first edition of *Economic Analysis of Law* was widely reviewed by scholars in both law and economics.<sup>15</sup> In the second edition, Posner has made specific reference to some of the criticisms of the first edition and has incorporated some, but not all, of the suggestions made by the reviewers. One would expect that an author of a second edition would attempt to respond to the principal criticisms raised by the reviewers of the first edition, as well as to try to bring the first edition up to date. To the extent that Posner has ignored principal criticisms, or has emphasized prior eccentricities or questionable characteristics, one may be fairly critical indeed.<sup>16</sup> In reviewing the second edition, this Comment will also seek to determine whether, in light of prior criticisms, *Economic Analysis of Law* survives as an effective pedagogical tool.

In Part I this Comment reviews the organizational content of the second edition of *Economic Analysis of Law*, identifies major revisions and substantive additions, and highlights Posner's pedagogical approach. Part II, in turn, reviews the fundamental concepts and the methodological theme of *Economic Analysis of Law* as well as suggests areas in which

13. Ackerman, *supra* note 1, at x. It should be noted that in stating the case for utilizing an economic perspective in the traditional property law course, Professor Ackerman, unlike Professor Posner, is careful to warn the reader of the potential dangers of adopting such an approach. In Professor Ackerman's view, the greatest danger is that an economic perspective may encourage the "naïve belief that the economist's notion of 'efficiency' is sufficiently embracing so as to provide a comprehensive touchstone for policy judgments." *Id.* at xi. See text accompanying note 79 *infra*.

14. While Posner has suppressed the jargon of economics from his book, this Comment will review *Economic Analysis of Law* in the conventional terminology and theory of neo-classical economics.

15. See Baker, *The Ideology of the Economic Analysis of Law*, 5 PHILOSOPHY & PUB. AFF. 3 (1975); Buchanan, *Good Economics—Bad Law*, 60 VA. L. REV. 483 (1974); Carrington, *Book Review*, 1974 U. ILL. L.F. 187; Diamond, *Posner's Economic Analysis of Law*, 5 BELL J. ECON. & MANAGEMENT SCI. 294 (1974); Krier, *Book Review*, 122 U. PA. L. REV. 1664 (1974). Leff, *supra* note 8; Polinsky, *Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law*, 87 HARV. L. REV. 1655 (1974); Williams, *Book Review*, 45 U. COLO. L. REV. 437 (1974).

16. In the Preface to the second edition Posner identifies and rejects three criticisms of the first edition:

Three criticisms of the first edition I reject. The first is that the book insufficiently distinguishes the normative from the positive uses of economics in the study of law; that distinction was (and remains) a point stressed in the text. The second is that the book fails to deal in sufficient depth with the various legal areas discussed. This criticism misconceives the purpose of the book, which is intended not as a treatise on the American legal system but as a textbook on the use of economics to illuminate legal questions; those questions are therefore treated illustratively rather than exhaustively. Obviously I do not think the law of federal taxation, for example, can be treated adequately in the compass of a short chapter. But it is not my purpose to survey the law of federal taxation; my purpose is to suggest some problems in the field of taxation which economic analysis illuminates. The third criticism is that by limiting discussion to the economic analysis of law the book provides too narrow a perspective on legal problems; one reviewer took me to task for not citing any anthropologists' studies of property rights. But my purpose was not and is not to present the sociological, the anthropological, or the philosophical approach to law; it is to present the economic approach—matter enough for a book.

ECONOMIC ANALYSIS II, *supra* note 7, at xvii-xviii (footnotes omitted).

further economic sophistication is needed. Part III discusses the role of assumptions in Posner's analysis and the normative perspective that his analysis embraces. Finally, Part IV evaluates and summarizes problems and limitations in utilizing *Economic Analysis of Law* as a pedagogical tool in law school teaching.

## I. THE ORGANIZATIONAL CONTENT AND PEDAGOGICAL APPROACH

### A. *Revisions and Additions*

*Economic Analysis of Law* first appeared in 1973 and was prepared mainly in 1972. As Posner states in the Preface to the second edition, "the literature on the application of economics to law has grown substantially, and as a result the first edition is now out of date."<sup>17</sup> Thus, the second edition has been prepared with the main objective of incorporating the recent literature in the field of law and economics.<sup>18</sup> These recent findings mainly concern the substantive topics of tort rights and remedies,<sup>19</sup> property,<sup>20</sup> contracts,<sup>21</sup> family law,<sup>22</sup> corporate finance,<sup>23</sup> banking and trust investment,<sup>24</sup> judicial process,<sup>25</sup> legal rulemaking and law enforcement.<sup>26</sup>

17. *Id.* at xvii.

18. The interdisciplinary field of law and economics has both an "old" and a "new" component. See Posner, *The Economic Approach to Law*, 53 TEXAS L. REV. 757 (1975). The "old" component, which is now well established, involves the application of economic analysis to law school subjects such as antitrust and regulated industries in which the legal issues invariably require the decision-maker to turn to economics. See, e.g., Massel, *Economic Analysis on Judicial Antitrust Decisions*, 20 A.B.A. ANTITRUST SECTION 46 (1962). The "new" component, which is mainly covered in Posner's book, involves the application of economic analysis to common-law subjects such as contracts, property, torts and criminal law, where the relevance of economics is less apparent. The new component origin can be traced to the early 1960s and the publication of Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1 (1960), and Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961). Since 1960, the literature of the new field of law and economics has expanded to include well over two hundred treatises and journal articles. The major contributors to the field include some of the most well-known scholars of both law and economics—a reflection of the truly interdisciplinary character of the research. Some of this work is collected and briefly surveyed in Samuels, *Legal-Economic Policy: A Bibliographical Survey*, 58 LAW LIBRARY J. 230 (1965), and Samuels, *Law and Economics: A Bibliographical Survey, 1965-1972*, 66 LAW LIBRARY J. 96 (1973).

19. See Conley, *The Value of Human Life in the Demand for Safety*, 66 AM. ECON. REV. 45 (1976); Komisar, *Toward a General Theory of Personal Injury Loss*, 3 J. LEGAL STUD. 45 (1974); Reder, *An Economic Analysis of Medical Malpractice*, 5 J. LEGAL STUD. 267 (1976); Thaler & Rosen, *The Value of Saving a Life: Evidence from the Labor Market*, in HOUSEHOLD PRODUCTION AND CONSUMPTION 265 (N. Terleckyj ed. 1975).

20. W. BAXTER, *PEOPLE OR PENGUINS: THE CASE FOR OPTIMAL POLLUTION* (1974); Munch, *An Economic Analysis of Eminent Domain*, 84 J. POL. ECON. 473 (1976).

21. See Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

22. See *ECONOMICS OF THE FAMILY* (T. Schultz ed. 1974); G. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* (1976).

23. See Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976).

24. See W. BAXTER, P. COOTNER & K. SCOTT, *RETAIL BANKING IN THE ELECTRONIC AGE* (1977); Langbein & Posner, *Market Funds and Trust-Investment Law*, 1976 AM. B. FOUNDATION RESEARCH J. 1.

25. Landes & Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J. LAW & ECON. 875 (1976).

26. See Becker & Stigler, *Law Enforcement Malfeasance and Compensations of Enforcers*, 3 J.

and market regulations.<sup>27</sup> The bulk of the new literature cited by Posner is Posnerian in origin.

Posner has not substantially altered the overall organizational content of the book. While the first edition of *Economic Analysis of Law* was divided into six major parts that followed an introductory chapter, the second edition is divided into seven.<sup>28</sup> Part I, "Law and Economics: An Introduction," incorporates the introductory material of the first edition,<sup>29</sup> adds a section on the role of assumptions in economic analysis,<sup>30</sup> and draws in part from a 1975 Texas Law Review article by Posner that reviews the new economic approach to law.<sup>31</sup>

Part II, "The Common Law," surveys the legal subjects traditionally contained in the first year curriculum and refines the methodological theme presented in the first edition. In reviewing the substantive areas of property, contract, tort, criminal and family law, Posner develops the view that "the common law exhibits a deep unity that is economic in character."<sup>32</sup> In the concluding chapter to Part II, entitled "The Unity and Morality of the Common Law," Posner summarizes the analytical theme of that portion of the book and provides some interesting commentary on the relationship between the economic and moral content of the common law. According to Posner, the common law can be viewed "as an effort to attach costs to the violation of moral principles—principles that we have suggested operate to enhance the efficiency of a market . . . economy."<sup>33</sup> The economic and moral interpretations of the common law are thus found to be in harmony.<sup>34</sup>

Part III, "Public Regulation of the Market," focuses primarily upon the substantive topics contained in courses in antitrust, regulated indus-

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LEGAL STUD. I (1974); Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Landes & Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J. LAW & ECON. 249 (1976); Landes & Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. I (1975).

27. R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE (1976); Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975); Posner, *Themes of Economic Regulation*, 5 BELL J. ECON. & MANAGEMENT SCI. 335 (1974).

28. For a review of the organization and coverage of the first edition, see Krier, *supra* note 15, at 1672-73.

29. See ECONOMIC ANALYSIS II, *supra* note 7, at 3-12; ECONOMIC ANALYSIS I, *supra* note 7, at 1-6. This material reviews the nature of economic reasoning and presents the fundamental concepts utilized in Posner's analysis.

30. This section, "The Realism of the Economist's Assumptions," ECONOMIC ANALYSIS II, *supra* note 7, at 12-14, was apparently added to the second edition in response to those who have criticized the economic approach on the ground that the assumptions of economic analysis are unrealistic. For a fuller examination of the position of the critics as well as Posner's response, see text accompanying notes 150-54 *infra*.

31. See Posner, *supra* note 18. The introductory material in the second edition also seeks to answer some of the more general criticisms of the application of economic analysis to legal problems. See ECONOMIC ANALYSIS II, *supra* note 7, at 19-23. For an alternative explanation of the economic approach that Posner has applied, see G. BECKER, *supra* note 22, at 3-14.

32. ECONOMIC ANALYSIS II, *supra* note 7, at 179.

33. *Id.* at 186.

34. *Id.* at 185.

tries and labor law.<sup>35</sup> Part IV, "The Law of Business Organizations and Financial Markets," reviews economic analysis relevant to courses in corporations and securities regulation. Part V, "Law and the Distribution of Income and Wealth," collects a mixture of topics relating to taxation, the transmission of wealth at death, and problems of distributive justice. In Part VI, "The Legal Process," Posner surveys a host of subjects covered in courses in procedure and legal process. The breadth of the analysis reaches both civil and criminal procedure as well as legal and administrative process. Part VII, "The Constitution and the Federal System," reviews selected topics of constitutional law, including, *inter alia*, the principle of separation of powers, substantive due process, federalism, racial discrimination and the economic basis of freedom of speech and individual liberty.

While the organizational content of the second edition of *Economic Analysis of Law* has not changed substantially, there are a number of revisions and substantive additions. In surveying the common-law subjects, for example, the first edition devoted a single chapter to "crimes and tort"<sup>36</sup> and gave but brief mention to family law in a section contained in a chapter on contracts.<sup>37</sup> The second edition has expanded these areas by devoting separate chapters to "The Criminal Sanction and Criminal Law," "Tort Rights and Remedies," and "Family Law." The chapters on criminal law and tort contain some new additions but are largely revisions of the material in the first edition.<sup>38</sup> The chapter on family law, however, contains mostly new material.<sup>39</sup>

Perhaps the most interesting addition to the chapter on family law is a section that develops an economic case for the legalization of the sale of babies.<sup>40</sup> That analysis is particularly useful for illustrating the "market

35. The material on "The Theory of Monopoly," *id.* at 195-209, and "The Antitrust Laws," *id.* at 211-37, is more fully developed in R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* (1976). For a review of that work, see Scherer, *The Posnerian Harvest: Separating Wheat from Chaff*, 86 YALE L.J. 974 (1977).

36. *ECONOMIC ANALYSIS I*, *supra* note 7, at 66-97.

37. *Id.* at 61-64.

38. The new additions include economic analysis of intentional torts, the reasonable man standard, medical malpractice, optimal criminal sanctions, multiple-offender laws and the defense of compulsion. *ECONOMIC ANALYSIS II*, *supra* note 7, at 119-22, 125, 157-59, 164-72, 172-73 and 175.

39. *Id.* at 101-18.

40. *Id.* at 111-16. Posner's economic case for legalizing baby sales is characteristic of the work of economists who have suggested that "children could be treated as durable consumer goods" for purposes of applying economic analysis to marriage and the family. See G. BECKER, *supra* note 22, at 169 (1976). See also T. SCHULTZ, *supra* note 22. In expanding upon that work, E. M. Landes and Richard Posner have recently developed a model of supply and demand for babies for adoption to show how the existing pattern of state regulation prohibiting baby sales has "created a baby shortage" as well as "contributed to a glut of unadopted children maintained in foster homes at public expense." Landes & Posner, *The Economics of the Baby Shortage*, 7 J. LEGAL STUD. 323-24 (1978). In presenting the case for legalizing baby sales, Landes and Posner have actually proposed that the states begin "taking some tentative and reversible steps toward a free baby market in order to determine experimentally the social costs and benefits of using the market in this area." *Id.* at 347. See also notes 42-43 and accompanying text *infra*.

approach" that Posner developed in the first edition and that has remained unchanged in the second edition. As Posner sees it, "[t]he problem of the abused or neglected child arises when the parents discover some time after the child is born that they are unwilling to make the minimal investment in the child's upbringing required by the state."<sup>41</sup> While the adoption laws enable parents to rid themselves of unwanted children, evidence of a "baby shortage" suggests to Posner that "the market for adopted children is not in equilibrium."<sup>42</sup> In his view, the market has failed because of "an artifact of government regulation, in particular the uniform state policy forbidding the sale of babies."<sup>43</sup> In suggesting the "possibility of a thriving baby market" as well as the failure of government regulation, Posner points to the reported evidence that has revealed the evidence of an illegal "black market in babies, with prices as high as \$25,000."<sup>44</sup>

Posner suggests that if parents were permitted to sell their children for "profit," the market might correctly allocate children to individuals who are "likely to give [them] the most care."<sup>45</sup> Since "willingness to pay" is generally regarded as a reliable "index of value," the reader is told that the "sacrifice of a substantial sum of money" can be regarded as an indication of the seriousness of the purchaser's desire to have children.<sup>46</sup> In response to those who might claim that the "rich would end up with all the babies,"

41. ECONOMIC ANALYSIS II, *supra* note 7, at 112.

42. Posner suggests that the "baby shortage" is partly a result of such factors as "[t]he wide availability and knowledge of contraception, the diminution in the stigma of being an unwed mother, and the legalization of abortion [which] have reduced to a trickle the supply of children for adoption" at the very time that "the demand for children for adoption is very high." *Id.* at 113. More recently, Landes and Posner have noted that the disequilibrium in the "adoption market" actually represents both a "shortage of white babies for adoption" and a "glut of black babies, and of children who are no longer babies (particularly if they are physically or mentally handicapped), for adoption." Landes & Posner, *supra* note 40, at 324-25. As they see it, "[j]ust as a buyer's queue is a symptom of a shortage, a seller's queue is a symptom of a glut. The thousands of children in foster care . . . are comparable to an unsold inventory stored in a warehouse." *Id.* at 327.

43. ECONOMIC ANALYSIS II, *supra* note 7, at 113. Posner argues that the regulation forbidding baby sales has actually provided private, non-profit adoption agencies with a monopoly over adoption in some states and that it has been the adoption agencies which "are the most vigorous opponents of allowing the sales of babies." *Id.* at 113-14. In developing their critique of such regulation, Landes and Posner have gone on to argue that the "social welfare professionals" have been strong proponents of state regulation because they would probably be eliminated by the "competitive margin" in a free baby market. Landes & Posner, *supra* note 40, at 347. This argument is explicitly made in "the spirit of the new economic analysis of the political process. . . ." *Id.* at 324 n.5 (citing Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MANAGEMENT SCI. 3 (1971), and Peltzman, *Toward a More General Theory of Regulation*, 19 J. LAW & ECON. 211 (1976)).

44. ECONOMIC ANALYSIS II, *supra* note 7, at 113 n.3 (citing *Adoption and Foster Care, 1975 Hearings before the Subcomm. on Children and Youth of the Senate Comm. on Labor and Pub. Welfare*, 94th Cong., 1st Sess. (1975)). He also notes the existence of a so-called "gray market" for babies, consisting of independent or non-agency adoptions where the payment for an adopted baby is allegedly concealed in the fee for services of the lawyer who arranges such adoption. *Id.* at 114. See also Landes & Posner, *supra* note 40, at 337-38.

45. ECONOMIC ANALYSIS II, *supra* note 7, at 114. To those who might claim that "high-paying adoptive parents may value the child for the wrong reasons"; e.g., to subject them "to sexual abuse or otherwise to exploit them," Posner argues that the existing "laws forbidding child neglect and abuse would presumably apply fully to the adoptive parents (as they do under present law, of course)." *Id.* at 114-15.

46. *Id.* at 114.



Posner argues that individuals with high incomes want smaller families, and that, in any event, prevailing adoption procedures already favor the rich.<sup>47</sup> In a "free baby market" Posner concludes that lower income groups might be able to buy children just as they are now "able to buy color television sets."<sup>48</sup>

Finally, for those who would find Posner's baby sale case to be morally offensive because it involves the "spectacle of 'trafficking' in human lives," Posner suggests that the "recent changes in public policy concerning abortion" have undermined such objections. As he puts it: "Is paying a pregnant woman to carry the child to term so offensive an alternative to the abortion of the fetus?"<sup>49</sup> While recognizing that the market approach is not a "complete panacea," Posner, nevertheless, advocates it as a plausible alternative to the current system of laws and regulations that have been explicitly enacted for the benefit of children.<sup>50</sup>

47. *Id.* at 115-16. Indeed, the suggestion is made that the price of a baby of "equivalent quality" may actually be much lower in a free baby market. As Posner explains:

In a free market, competition would tend to compress the price of babies for adoption to the opportunity costs of the natural mother [i.e., mainly the cost of the time lost due to pregnancy and actual medical expenses]. The net cost to the adoptive parents would be close to zero, except that the adoptive parents would incur some costs in locating and trying to ascertain the qualities of the child that they would not have incurred if they had been its natural parents.

*Id.* at 115. See also Landes & Posner, *supra* note 40, at 339-40.

48. *Id.* at 116.

49. ECONOMIC ANALYSIS II, *supra* note 7, at 116. Landes and Posner have suggested that those observers who have moral objections to their proposal may really "wish to disguise facts that might be actually uncomfortable if widely known [in a free baby market]." As they see it: "Were baby prices quoted as prices of soybean futures are quoted, a racial ranking of these prices would be evident, with white baby prices higher than nonwhite baby prices . . . [A]nyone who thinks about the question will realize that prices for babies are racially stratified as a result of different supply and demand conditions in the different racial groups . . ." Landes & Posner, *supra* note 40, at 344-45 (footnotes omitted). While recognizing that "bringing this fact out into the open [may] exacerbate racial tensions in our society," they nevertheless believe that these so-called "symbolic objections" are outweighed by the "substantial costs that the present system imposes on childless couples, aborted fetuses (if they can be said to incur costs), and children who end up in foster care." *Id.* at 345-46.

50. In the second edition, Posner acknowledges that his baby sale proposal may not be a "complete panacea; it is probably not usable in the case of the neglected or abused child. The market price of most such children would probably be negative." Moreover, "a complete analysis whether to permit the sale of babies . . . would consider the effect of a baby market on the rate of population change and, in turn, the social costs associated with such change." ECONOMIC ANALYSIS II, *supra* note 7, at 116.

Recently, however, Landes and Posner have advocated that the baby sale proposal actually be implemented on an experimental basis to obtain information on the demand and supply conditions in the adoption market and to "help answer the question whether the payment of a stiff fee has adverse consequences on the welfare of the child." Landes & Posner, *supra* note 40, at 348. As an interim step toward a "full-fledged baby market," they suggest that "a market could be simulated if one or more adoption agencies, which typically already vary their fees for adoption according to the income of the prospective parents, would simply use the surplus income generated by the higher fees to make side payments to pregnant women contemplating abortion to induce them instead to have the child and put it up for adoption." *Id.* at 347-48. Curiously, Landes and Posner have ignored at least one of the very qualifications that led Posner to initially conclude that the baby sale proposal "is not a complete panacea." ECONOMIC ANALYSIS II, *supra* note 7, at 116. Certainly, a "complete analysis" of the Landes-Posner proposal must be qualified by the detrimental effect a baby market would likely have on long-run policies dealing with population control and the production of children. See ECONOMIC ANALYSIS II, *supra* note 7, at 116-18. The social cost of encouraging the production of children may be a sufficient reason for rejecting the baby sale proposal irrespective of the results of the experiment proposed by Landes and Posner.

The economic case for the legalization of the sale of babies reveals two questionable characteristics of *Economic Analysis of Law*. First, in developing a common theme based on a market versus government approach to legal and social problems, the book invariably opts for "the lure of a simplistic 'just leave it to the market answer.'"<sup>51</sup> State laws that forbid the sale of babies, for example, are used to illustrate how government regulation can interfere with the "self-regulating" forces of the market. According to Posner, children can be "allocated" for adoption much like commodities are allocated in the market. Second, the analysis of legal problems blindly assumes that individuals are the best judge of their interests and that they will rationally seek to maximize their self-interest. The suggestion that parents might sell their children for "profit" might strike some readers as unrealistic. In Posner's view, however, the rational pursuit of self-interest is the primary, if not exclusive factor for predicting human behavior.<sup>52</sup> The unrealistic nature of the assumption is irrelevant to Posner's analysis.

There are other revisions and additions to *Economic Analysis of Law* that are worthy of mention. In Part III, "Public Regulation of the Market," the second edition has included a new section on antitrust remedies<sup>53</sup> and has expanded a chapter dealing with the regulation of the employment relation.<sup>54</sup> The new material concerns the interrelationship between labor and antitrust laws, minimum wage legislation, the Occupational Safety and Health Act (OSHA), and employment discrimination. In Part VI, "The Legal Process," the reader will find a new chapter entitled "The Process of Legal Rulemaking,"<sup>55</sup> which develops an economic interpretation for the role of precedent and the evolution of legal rules. In Part VII, "The Constitution and the Federal System," there is a new chapter that discusses the principle of separation of powers, the constitutional protection of rights, and rationality review.<sup>56</sup> The reader will also

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51. Randall, *Coasian Externality Theory in a Policy Context*, 14 *NAT. RESOURCES J.* 35, 41 (1974).

52. The assumption of rationality can be criticized on at least two levels. First, the assumption of rationality is based on predictions of aggregate behavior of a great number of individuals. The assumption, therefore, does not rule out the possibility of individual cases of irrationality. See, e.g., J. HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* 8 (1976). Indeed, one can argue that a dominant purpose for law is that it deals with the unpredictable case of individual irrationality. Second, the assumption of rationality tells us nothing about the underlying purposes or motives for human behavior. Professor Coase, for example, has recently noted that Posner's overall approach to human behavior has a major limitation in that it "tells us nothing about the purposes for which [people] engage in economic activity and leaves us without any insight into why people do what they do." Coase, *Economics and Contiguous Disciplines*, 7 *J. LEGAL STUD.* 201, 208 (1978). The problem, of course, is that sometimes people act rationally for the wrong reasons. See, e.g., Fried, *Right and Wrong: Preliminary Considerations*, 5 *J. LEGAL STUD.* 165 (1976).

53. *ECONOMIC ANALYSIS II*, *supra* note 7, at 234-37.

54. *Id.* at 239-49.

55. *Id.* at 419-28.

56. *Id.* at 491-96.

discover a new section on reverse discrimination in the chapter dealing with constitutional problems of racial discrimination.<sup>57</sup>

With the revisions and additions of the second edition the substantive content of *Economic Analysis of Law* now embraces almost every course in the law school curriculum. In the confines of a textbook Posner sets out to weave the "exposition of the relevant economic principles into a systematic (although necessarily incomplete) survey of the rules and institutions of the legal system."<sup>58</sup> Thus the second edition, like the first, is in many respects "quite obviously a tour de force."<sup>59</sup> Not since William Blackstone has a legal scholar attempted to capture the corpus of the law in the confines of a single treatise.<sup>60</sup> Indeed, while it took Blackstone four volumes to survey the laws of England,<sup>61</sup> Posner's "systematic survey" of American law takes only one. Unlike Blackstone's *Commentaries*, however, Posner's legal survey requires the reader to master relevant principles of *law and economics*, and therein lies the rub.

In fact, one criticism of the first edition was that the book's treatment of the various legal areas was necessarily incomplete and thus flawed by a certain "lightness of touch."<sup>62</sup> In his review of the first edition, for example, Professor Krier asked "[C]an one really deal adequately with estates in land in two pages, personal income taxation in ten, freedom of speech in nine, exclusionary rules of evidence in three, restraints on alienation and the rule against perpetuities in one, or labor law in five?"<sup>63</sup> Although Posner acknowledges this criticism in the Preface to the second edition, he nonetheless rejects it on the ground that it is based on a fundamental misconception of his book. As Posner explains:

This criticism misconceives the purpose of the book, which is intended not as a treatise on the American legal system but as a textbook on the use of economics to illuminate legal questions; those questions are therefore treated illustratively rather than exhaustively. Obviously I do not think the law of federal taxation, for example, can be treated adequately in the compass of a short chapter. But it is not my purpose to survey the law of federal taxation; my purpose is to suggest some problems in the field of taxation which economic analysis illuminates.<sup>64</sup>

57. *Id.* at 536-38.

58. *ECONOMIC ANALYSIS II*, *supra* note 7, at xxi-xxii.

59. Krier, *supra* note 15, at 1673.

60. In his review of the first edition, Professor Paul D. Carrington noted that "Professor Posner's accomplishment is that he has reunited two divergent strands of rational intellectual tradition, the classical economic rationalism sired by Adam Smith and the common law rationalism which can be said to date from William Blackstone." Carrington, *supra* note 15, at 187 (footnotes omitted). To Carrington, many features of Posner's book "suggest[ed] that it might have been written either by a resurrected Smith or a resurrected Blackstone." *Id.* To this reviewer, Posner has resurrected not only Smith and Blackstone, but Langdell as well.

61. See W. BLACKSTONE, *COMMENTARIES ON THE LAWS OF ENGLAND*.

62. Krier, *supra* note 15, at 1673.

63. *Id.* at 1675 (footnote omitted).

64. *ECONOMIC ANALYSIS II*, *supra* note 7, at xviii.

It would, of course, be unfair to expect that *Economic Analysis of Law* would or even could exhaustively consider every facet of the legal subjects it purports to survey, even if that were a purpose of the book. As the author of a textbook on the economic analysis of law, Posner certainly cannot be criticized for failing to deal with every legal subject in a comprehensive fashion. On the other hand, one can fairly ask, as Professor Krier does in his review, whether the book would be a more effective pedagogical book if it were limited to a selected legal area or a limited number of subjects. As it now stands, the breadth of the analysis may require the teacher and student to spend too much time reviewing and supplementing the legal material instead of focusing on the economic analysis.

### B. *Posner's Pedagogical Approach*

Since Posner's *Economic Analysis of Law* was intended to show how economics can be used to illuminate legal questions, its pedagogical success or failure must ultimately be judged in terms of its effectiveness in instructing law students on the *art* of economic analysis. Indeed, while the book promises a unified theory for approaching a broad range of legal problems, its analysis necessarily requires a modicum of economic sophistication. Posner's pedagogical approach for acquiring that sophistication, therefore, requires careful scrutiny.

In the Preface to the first edition, Posner outlines the pedagogical objectives of *Economic Analysis of Law*. Those objectives have remained unaltered in the second edition. The underlying objective is to force the law student and teacher "to confront economics not as a body of abstract theory but as a practical tool of analysis with a remarkably broad application to the varied problems of the legal system."<sup>65</sup> The overall approach thus seeks to "anchor discussion of economic theory in concrete, numerous, and varied legal questions" as opposed to a discussion of economics in the abstract.<sup>66</sup> Moreover, except for a brief introductory chapter that reviews but three fundamental concepts of economics,<sup>67</sup> the book explicitly avoids discussing economics as a separate and cohesive body of knowledge. In Posner's view "[t]he emphasis on concrete application rather than abstract theory should be congenial to the law student trained by the case method."<sup>68</sup>

At the same time, Posner has made the strategic decision to suppress the use of the terminology of economics in concrete applications. "The relentless if not complete suppression in the book of the jargon of modern welfare economics ('Pareto Optimality' and the like) is designed to prevent

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65. *Id.* at xxii.

66. *Id.* at 3.

67. *Id.* at 3-14.

68. *Id.* at xxii.

the student from confusing economic analysis with the mastery of a vocabulary."<sup>69</sup> As a tool of analysis economics is thus stripped of its terminology as well as its explicit theory.

Finally, Posner has also decided to ignore any mention of the limitations of economics as an interpretative and normative tool of analysis. Posner justifies this omission in the belief that the limitations of economics will be given sufficient consideration in the course of classroom discussion of problems. As Posner states in the Preface:

The text is, I hope, sufficiently clear in most places that the instructor will not be obliged to translate it into still simpler terms for his students. He should be able to use class time to probe the depth of the students' understanding, both by putting questions to them based on the text and by working through with them the problems that appear in footnotes and at the end of chapters; many of the problems carry the analysis into areas not covered by the text. The instructor will also want to use class time to explore limitations of economic analysis, as both an interpretative and a normative tool. I have not emphasized these limitations in the text, in part to provoke student and instructor to challenge it by formulating and arguing those limitations. I predict that students will undertake the task with relish.<sup>70</sup>

Thus, Posner's pedagogical approach to the study of law and economics can be summarized follows: In balancing the competing objectives of economic sophistication and legal relevance, the balance is struck almost exclusively in favor of legal relevance. The overall strategy is to force law students and teachers to learn economic analysis by the repetitive exercise of applying it to a series of concrete problems. To simplify the task, economics is treated as a mere tool of analysis; the discussion of economic theory in the abstract is avoided and the technical jargon of the economist is suppressed. While limitations of the analysis are recognized to exist, the belief is that they will be mystically "discovered" in the course of examining concrete applications. An implicit assumption is that the student and teacher will instinctively discover all that is necessary and useful to know about economics from the application of a limited number of fundamental concepts.

While Posner's emphasis on concrete applications rather than abstract theory is a good approach overall, there is reason to question whether his book will accomplish the goals that the interdisciplinary study of law and economics should pursue. At a bare minimum, the course in law and economics should provide law students with a measure of familiarity with the terminology and language of economics. In approaching an interdisciplinary course, the law teacher's task is "to meld the learning of the two or more disciplines, rather than merely to permit those

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69. *Id.*

70. *Id.* at xxiii.

disciplines to coexist proximately in mutual ignorance."<sup>71</sup> In integrating the disciplines of law and economics, attention must necessarily be given to problems of communication and language.

Indeed, if law students are to be expected to carry forward the learning of *Economic Analysis of Law* in subsequent work, they must be able to communicate in the language of economics as well as law. In suppressing the technical jargon of economics from his book, Posner makes it difficult, if not impossible, for students to develop an understanding of economics as a discipline and to apply that knowledge in other areas. As Professor Paul D. Carrington observed in his review of the first edition: "Students could devote quite a substantial effort to the book without improving substantially their ability to communicate with economists, to explore economics literature on their own, or to invoke substantive knowledge of economics in the solution of public problems not addressed by Posner."<sup>72</sup> Unfortunately, the second edition has ignored Carrington's suggestion.

It is also essential that the student and teacher attain at least an elementary understanding of the major limitations and assumptions of the theory upon which the economic analysis of law is based. Posner, however, has failed to provide adequate guidance for obtaining that knowledge.<sup>73</sup> Of course law students will probably challenge the instructor with questions concerning the limitations and assumptions laden in the analysis of problems in the book. But will the students be able to identify all the potential limitations? And where will the teacher find the answers?<sup>74</sup> While the non-economist must be warned of the limitations and assumptions of the economics that has been applied, in practice such a warning requires the non-economist to learn a considerable amount of theory.<sup>75</sup> The danger is that an oversimplified treatment of economics may give the unwarranted impression of clarity when there is in fact

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71. Gorman, *Proposals for Reform of Legal Education*, 119 U. PA. L. REV. 845, 848 (1971).

72. Carrington, *supra* note 15, at 191.

73. In the Preface to the first edition, Posner does suggest G. BECKER, *ECONOMIC THEORY* (1971) and G. STIGLER, *THEORY OF PRICE* (3d ed. 1966), as "two excellent but difficult textbooks on price theory" for those who seek extra guidance in economics. As Posner notes in the Preface to the second edition, *id.* at xviii, there is now a new addition to the list of available microeconomic textbooks. *E.g.*, J. HIRSHLEIFER *supra* note 52. In addition to the supplementary readings suggested by Posner, the reader may also find help by consulting either D. DEWEY, *MICROECONOMICS* (1975) (a highly readable and comprehensive review of microeconomic theory with particular emphasis on its limitations and assumptions), or W. BAUMOL, *ECONOMIC THEORY AND OPERATIONS ANALYSIS* (4th ed. 1977) (a more sophisticated and mathematical treatment). For a classic introduction and discussion of the limitations of welfare economics, a branch of microeconomic theory relevant to *Economic Analysis of Law* see J. GRAAFF, *THEORETICAL WELFARE ECONOMICS* (1957), and I. LITTLE, *A CRITIQUE OF WELFARE ECONOMICS* (2d ed. 1957).

74. While Posner has provided the teacher (not students) with a *Teacher's Manual* for guidance on the problems and questions in the text, its discussion is admittedly preliminary and incomplete. *See* R. POSNER, *TEACHER'S MANUAL FOR ECONOMIC ANALYSIS OF LAW* (1977). *See also*, Krier, *supra* note 15, at 1698. What is really needed is a manual on economics for the non-economist.

75. *See* I. LITTLE, *supra* note 73, at 127.

complexity and reason for caution. Although the reviewers of the first edition warned of this danger,<sup>76</sup> Posner has ignored the warning.

The major question that should be raised about Posner's pedagogical approach is whether the trade-off of economic sophistication for legal relevance is worth the price. The tension between the goals of economic sophistication and legal relevance is undeniably a major pedagogical problem presented by the study of law and economics. For the law teacher the problem is one of devising the best means for imparting economics to students "in a way that is both relatively sophisticated and legally relevant."<sup>77</sup> Certainly it would be a mistake to transform the study of law and economics into an undergraduate course in microeconomic theory. After all, the a priori justification for the role of economics in the law school curriculum is that it is relevant for the analysis of legal problems.<sup>78</sup> On the other hand, the demands of legal relevance should not be pressed to the point that students lose sight of the significance of economics as a discipline. The time devoted to the study of law and economics will be wasted if the effort fails to equip students with at least an elementary understanding of the relevant theory, terminology, history, and limitations of economic analysis.

While there are admittedly no easy solutions for reconciling the conflicting objectives of economic sophistication and legal relevance, the problem cannot be resolved by treating economics or law with superficial clarity. In the sections that follow this Comment will attempt to provide some guidance for identifying areas where *Economic Analysis of Law* requires further sophistication and development.

## II. THE FUNDAMENTAL CONCEPTS AND METHODOLOGY

### A. "Fundamental Concepts of Economics"

To comprehend the methodological theme that is developed in *Economic Analysis of Law* one must first review the economic concepts that Posner has selected as the basis for his analysis. In this regard, perhaps the most surprising feature of the book is that the discussion of economic theory is confined to only three "fundamental concepts of economics."<sup>79</sup>

In an introductory chapter Posner sets forth the economic principles that serve as the foundation for the subsequent analysis. The cardinal principle of economics from which the three fundamental concepts emerge is the assumption that "man is a rational maximizer of his ends in life."<sup>80</sup>

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76. See, e.g., Krier, *supra* note 15; Polinsky, *supra* note 15.

77. Ackerman, *supra* note 12, at xi.

78. See, e.g., Lovett, *Economic Analysis and Its Role in Legal Education*, 26 J. LEGAL EDUC. 385 (1974).

79. ECONOMIC ANALYSIS II, *supra* note 7, at 3-12.

80. *Id.* at 3.

This assumption is found to be implicit in Posner's definition of economics: "Economics, the science of human choice in a world in which resources are limited in relation to human wants, explores and tests the implications of assuming that man is a rational maximizer of his ends in life, his satisfactions—what we shall call his 'self-interests.'"<sup>81</sup> As Posner points out, "[i]t is implicit in the definition of man as a rational maximizer of his self-interest that people respond to incentives—that if a person's surroundings change in such a way that he could increase his satisfactions by altering his behavior, he will do so."<sup>82</sup>

From his definition of economics<sup>83</sup> Posner derives three fundamental concepts. "The first is the inverse relation between price charged and quantity demanded,"<sup>84</sup> or what the economist calls the "Law of Demand."<sup>85</sup> According to Posner, the law of demand has many applications to the legal system:

The convicted criminal who has served his sentence is said to have "paid his debt to society," and an economist would find the metaphor apt. Punishment is the price that society charges for a criminal offense. The economist is led to predict that an increase in either the severity of the punishment or the likelihood of its imposition will raise the price of crime and therefore reduce its incidence. The criminal will be encouraged to substitute other activity.<sup>86</sup>

The second fundamental concept is the economic definition of cost. "Cost to the economist is 'opportunity cost'—the benefit forgone by employing a resource in a way that denies its use to someone else."<sup>87</sup>

81. *Id.*

82. *Id.* at 4.

83. By defining economics as the "science of human (i.e., rational) choice," Posner's definition "fall[s] into [the] error of including virtually all intelligent behavior." F. KNIGHT, *THE ECONOMICS OF ORGANIZATION* 3 (1951). "Such definitions come too near to saying that economics is the science of things generally, of everything that men are for practical reasons interested in." *Id.* at 4. See also Coase, *Economics and Contiguous Disciplines* 7 J. LEGAL STUD. 201, 206 (1978).

The discipline of economics is, of course, characteristically a social science. Like many of the social sciences, economics is devoted to the study of how society is organized and how individuals interact within that organization. What distinguishes economics from other disciplines within the social sciences is that "[e]conomics specializes in the study of that part of the total social system which is organized through exchange and which deals with exchangeables." Boulding, *Economics as a Moral Science*, 59 AM ECON. REV. 1, 4 (1969). See also F. KNIGHT at 6; Coase at 206-07. While many definitions of economics can be found in the textbooks, a commonly accepted definition is that [e]conomics is the study of how people and society end up *choosing*, with or without the use of money, to employ *scarce* productive resources that could have alternative uses, to produce various commodities and distribute them for consumption, now or in the future, among various persons and groups in society. It analyzes the costs and benefits of improving patterns of resource allocation.

P. SAMUELSON, *ECONOMICS* 3 (10th ed. 1976) (emphasis in original).

84. ECONOMIC ANALYSIS II, *supra* note 7, at 4.

85. *Id.* at 5.

86. *Id.* at 5-6 (footnote omitted).

87. *Id.* at 6. The concept of opportunity cost is based on the simple but important idea that there are costs associated with every decision. As Professor Samuelson explains:



Again, Posner finds that the opportunity cost concept has application in the analysis of legal problems:

Among the many applications of the concept of opportunity cost to law, consider the problem of computing damages for the loss of a child's life. If the child has no earning power, his death will not have imposed a pecuniary cost on the parents. However, we can compute the opportunity costs of the resources invested by the parents in rearing the child by determining the alternative price of the parents' time and other inputs (food, clothing, education, etc.) into its rearing. The sum of these prices is a minimum estimate of parental loss . . . .<sup>88</sup>

The third basic concept is "the tendency of resources to gravitate toward their most valuable uses if voluntary exchange—a market—is permitted."<sup>89</sup> As Posner further explains: "By a process of voluntary exchange, resources are shifted to those uses in which the value to consumers, as measured by their willingness to pay, is highest. When resources are being used where their value is highest, we may say that they are being employed efficiently."<sup>90</sup>

This last concept, the economist's notion of economic efficiency, is the most important concept of the three for understanding the methodological theme of *Economic Analysis of Law*. Because it is central to Posner's "market approach" to legal analysis, it is important to understand what is meant by his so-called "efficiency criterion." As Posner defines the operative terms: "The terms 'value' and 'efficiency' are technical terms. 'Efficiency' means exploiting economic resources in such a way that 'value'—human satisfaction *as measured by aggregate consumer willingness to pay* for goods and services—is maximized."<sup>91</sup> To follow what Posner means by the term of economic efficiency it is necessary to consider some other related concepts of economics.<sup>92</sup>

First, in order to understand Posner's use of "efficiency criterion" it is important to distinguish three different meanings of the term *efficiency*—technical, administrative, and economic. Administrative efficiency, a traditional concern of decision-makers, seeks to ensure that the administrative cost of implementing a proposed rule or practice will be minimized and that the rule will actually accomplish the function it was designed to

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Thus Robinson Crusoe pays no money to anyone, but realizes that the cost of picking strawberries can be thought of as the sacrificed amount of raspberries he might otherwise have picked with the same time and effort or sacrificed amount of forgone-leisure[sic]. The sacrifice of doing something is called "opportunity cost."

P. SAMUELSON, *supra* note 83, at 475.

88. ECONOMIC ANALYSIS II, *supra* note 7, at 7 (footnote omitted).

89. *Id.* at 9.

90. *Id.* at 10.

91. *Id.* (emphasis in original).

92. The following discussion of economics is offered merely for purposes of providing some introductory guidance for the reader untrained in economics. It would, of course, be beyond the scope of this Comment to attempt a review of all the subtleties and complexities of the economic theory relevant to Posner's book.

perform. In legal decision-making, administrative efficiency is perhaps the simplest reason for favoring one rule over another.<sup>93</sup> Technical efficiency, a concern primarily of engineers, seeks to determine the maximum amount of output that can result from the allocation of productive resources in society. It determines which uses of scarce resources would generate the largest bundle of goods and services.

While economic efficiency is sometimes confused with administrative and technical efficiency, it is a much broader concept than the latter two. Economic efficiency is concerned with how scarce resources are allocated among alternative productive uses and the resulting mix or selection of goods and services that are produced.<sup>94</sup> Economic efficiency is not only concerned with minimization of the costs of implementation (administrative efficiency) and maximization of output (technical efficiency), but also with the welfare of society—whether the actual mix or selection of goods and services are produced in accordance with what people want and can afford.<sup>95</sup>

The second point that should be noted about Posner's efficiency criterion is that it is based on the economist's concept of "Pareto optimality."<sup>96</sup> Pareto optimality is an evaluation concept developed by welfare economists for determining when one state of economy is "better than another in strictly economic terms." As Calabresi and Melamed have explained:

Economic efficiency asks that we choose the set of entitlements which would lead to that allocation of resources which could not be improved in the sense that a further change would not so improve the condition of those who gained by it that they could compensate those who lost from it and still be better off than before. This is often called Pareto optimality.<sup>97</sup>

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93. See Calabresi & Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1093 (1972); Greenawalt, *Discretion and Judicial Decision: The Elusive Quest for Fetters that Bind Judges*, 75 COLUM. L. REV. 359, 391-2 (1975).

94. See D. DEWEY, *supra* note 73, at 215-16. (Professor Dewey uses the term "welfare" efficiency for "economic" efficiency.)

95. See Calabresi & Melamed, *supra* note 93 at 1093-94.

96. Pareto optimality takes its name from welfare economist Vilfredo Pareto, who developed the concept. V. PARETO, *MANUEL D'ECONOMIE POLITIQUE* (2d ed. 1972). The logical foundation for the concept of Pareto optimality is based on the assumptions that each individual is the best judge of his or her happiness and what economists call the impossibility of making interpersonal comparisons of well-being. See Boulding, *supra* note 83, at 5-6. D. DEWEY, *supra* note 73, at 215. While some writers use the terms Pareto optimality and economic efficiency interchangeably, others have preferred the technically more precise term "Pareto efficiency" to distinguish optimality in resource allocation from broader concept of social optimality in the overall welfare of society. See Polinsky, *supra* note 15, at 1663 & n.45. The distinction is that it is possible for society's resource allocation to be Pareto efficient when the prevailing distribution of wealth and income is socially undesirable. The important point to be emphasized is that the Pareto criterion takes the prevailing distribution of wealth and income in society as a given and is thus at best only a necessary but not sufficient condition for attaining the socially optimum level of well-being in society. See Polinsky, *supra* note 15, at 1668-69. See also Baker, *supra* note 15; Thurow, *Toward a Definition of Economic Justice*, 31 PUB. INTEREST 56 (1973).

97. Calabresi & Melamed, *supra* note 93, at 1093-94. While the Pareto optimality concept has been subject to many definitional variations, see *id.*, at 1094 n.10, Calabresi and Melamed's definition conforms to the definition found in most economic theory texts. See e.g., D. DEWEY, *supra* note 73, at 214. It is important to note that while the Pareto criterion is usually defined in terms of a

In other words an economically efficient allocation of resources would be Pareto optimal in the sense that no reallocation(s) could be achieved that would improve one person's economic welfare without making anyone else worse off.

The Pareto principle is important to the concept of economic efficiency because it supplies a normative justification for favoring legal outcomes that are efficient in the economic sense. It is indeed difficult to argue against a standard which by definition seeks to make at least one person better off without making anyone else worse off.<sup>98</sup> On the other hand, it should be apparent that the Pareto principle has limited applicability for evaluating most real world changes. The Pareto principle, for instance, will be violated whenever some proposed change would benefit some and harm others and the gainers could not compensate the losers for the losses and still be better off. Since few real world changes harm no one, the vast majority of policy proposals cannot be judged with the aid of the Pareto principle alone.<sup>99</sup> This is particularly significant since the economic effect of a proposed change can never be known in advance of the event. The other important point to note about the Pareto principle is that it takes the prevailing distribution of wealth and income as a given and is thus at best a necessary, but not sufficient, condition for judging the well-being of society. Thus, it is possible for society's resource allocation to be Pareto efficient when the prevailing distribution of wealth and income is socially undesirable.<sup>100</sup>

Another important concept necessary for understanding Posner's efficiency criterion is marginal analysis—the principle that economists utilize for solving problems of “maximization.” As Posner tells the reader, “‘efficiency’ means exploiting economic resources in such a way that ‘value’—human satisfaction *as measured by aggregate consumer willingness to pay* for goods and services—is maximized.”<sup>101</sup> But how does one know when value is maximized? The answer is supplied by one

compensation test (that is, can the gainers compensate the losers and still be better off than before?). this does not mean that compensation actually is paid if such a change is made, but only that it could be paid. See, e.g., Hicks, *The Foundation of Welfare Economics*, 49 *ECON. J.* 696, 711-12 (1939).

98. The concept of Pareto optimality has both a strong and a weak sense. The weak version of the concept is that a social state is Pareto optimal if, and only if, it is not possible to move to any other state without making at least one person worse off. The strong version provides that a social state is Pareto optimal if, and only if, at least one person believes himself better off and nobody believes himself worse off. Ackerman, *supra* note 1, at xi-xii. The discussion in the text refers to the strong or “superior” version of the Pareto optimality concept.

99. See W. BAUMOL, *supra* note 73, at 527 (“[i]n other words, the Pareto criterion works by side-stepping the crucial issue of interpersonal comparison and income distribution, that is, by dealing only with cases where no one is harmed so that the problem does not arise.”).

100. For example, if income and wealth are not distributed equitably, then the efficient outcome achieved by the market will fail to reflect the interest of those who lack sufficient purchasing power. “An individual with no income or wealth may have needs and desires but no economic demands. . . . The market quite efficiently adjusts to an inequitable distribution of purchasing power.” Thurrow, *supra* note 96, at 57. See note 96 *supra*.

101. ECONOMIC ANALYSIS II, *supra* note 7, at 10.

of the most fundamental and elementary ideas of economics—marginal analysis.<sup>102</sup>

Marginal analysis entered economics in the nineteenth century when economists discovered differential calculus and applied it to formulate and solve problems of maximization. Modern analysis of economic efficiency seeks to determine when the net value of some activity is maximized, net value being the difference between the benefits and costs of the pursuing activity. Marginal analysis provides that the net value will be maximized when the additional cost of expanding the activity—marginal cost—equals the resulting additional or marginal benefit. When marginal cost equals marginal benefit, further expansion will cost more than it is worth, and a reduction in the activity would reduce benefits more than it would save costs.<sup>103</sup> At that point the net value from the activity will be maximized. When applied to legal decision-making, marginalism provides that the decision-maker should evaluate the costs and benefits of alternative legal outcomes by taking into account the marginal gain as opposed to simply comparing aggregate totals.

Finally, the efficiency criterion is an important attribute of the economist's model of perfect competition, or what Professor Polinsky has referred to as the "competitive market paradigm."<sup>104</sup> Economists have demonstrated that in the perfectly competitive market with no externalities in production, the pursuit of individual self-interest will lead to an allocation of resources that is Pareto efficient.<sup>105</sup> Theoretically, this means that the economic value of production and exchange in the economy would move toward an optimum level for a given distribution of wealth and income, and the economy would, with existing technology, be producing the largest bundle of goods and services in accordance with what people want and can afford. For every possible distribution of income and wealth as well as for each "set of tastes and technology," the

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102. For an introductory discussion of marginal analysis, see W. BAUMOL, *supra* note 73, at 21-41. See also Ruff, *The Economic Common Sense of Pollution*, 19 PUB. INTEREST 69, 70-71 (1970).

103. This assumes that as the level of activity increases both benefits and costs will increase, but because of the law of diminishing returns costs will increase faster than benefits.

104. Polinsky, *supra* note 15, at 1665-69. See also D. DEWEY, *supra* note 73, at 127, 139, 141-54.

In reviewing the first edition of *Economic Analysis of Law*, Professor Polinsky lamented that Posner failed to provide guidance for understanding the competitive market paradigm that underlies the methodological theme of the book. In seeking to fill this gap, Professor Polinsky has set forth a highly useful synthesis of the relevant economic theory of competitive markets. This synthesis is needed to understand the logic of Posner's analysis, as well as its assumptions and limitations. Indeed, Polinsky's constructive criticisms and comments of the first edition provide an indispensable supplement to either edition of *Economic Analysis of Law*. Unfortunately, Posner has refused to either provide the reader with similar guidance or explain why that guidance has been withheld.

105.

Under perfectly perfect competition, where all prices end up equal to all marginal costs, where all factor-prices end up equal to values of marginal-products and all total costs are minimized, where the genuine desires and well-being of individuals are all represented by their marginal utilities as expressed in their dollar voting—then the resulting equilibrium has the efficiency property that you can't make any one man better off without hurting some other man.

P. SAMUELSON, *supra* note 83, at 634.

competitive market would lead to the Pareto efficient equilibrium state.<sup>106</sup> The significance of this is that it establishes the normative case for competitive markets and provides the argument against state interferences in market activity. In fact, the classical and contemporary case for preserving competitive markets is based in part in the belief that the market is necessary for economic efficiency.<sup>107</sup>

In *Economic Analysis of Law* Posner has used the economic logic of competitive markets as a descriptive and normative tool for analyzing the doctrines and institutions of the legal system. For Posner the market and legal system are similar in operation.<sup>108</sup> Like the market, the legal system is viewed as a competitive process in which the pursuit of self-interest serves to promote an efficient allocation of resources. The "invisible hand" of the market, for example, is found to have "its counterpart in the aloof disinterest of the judge."<sup>109</sup> The adversary system is, in turn, seen as a competitive process that forces the decision-maker to act as a consumer in deciding "between the similar goods of two fiercely determined salesmen."<sup>110</sup> As in the market, the doctrines of the legal system are found to create economic incentives that encourage individuals to maximize efficiency.<sup>111</sup> Finally, "[l]ike the market, the legal system confronts the individual with the costs of his act but leaves the decision whether to incur those costs to him."<sup>112</sup> The ultimate question for decision in many lawsuits is thus seen to turn on the outcome that would mimic the market allocation and use of resources.

### B. *The Coase Theorem and the Common Law*

The theoretical support for Posner's market approach is derived from the so-called Coase Theorem,<sup>113</sup> which was formulated by Ronald Coase, Posner's colleague in the economics department at the University of Chicago. It is the Coase Theorem that serves as the intellectual core of Posner's market approach to legal analysis.

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106. Polinsky, *supra* note 15, at 1667. The ideal Pareto efficient state would, in theory, arise from some initial distribution of income and wealth that is considered socially appealing or just. Polinsky identifies "the attainment the socially optimal organization of society as a two-staged process. First, redistributing income until the most desirable distribution is achieved, and then allowing competitive markets to determine the Pareto efficient allocation of resources for this distribution." *Id.* at 1668-69. Most economists, however, stop short of addressing the public policy questions associated with the first stage of this process: Should one person's welfare, or wealth, be increased at the expense of another's? *Id.* at 1669. But see Thurow, *supra* note 96.

107. There are, of course, other non-economic or "political" arguments that have been advanced in defense of the classical model of perfect competition. See e.g., H. SIMMONS, *ECONOMIC POLICY FOR A FREE SOCIETY* (1948).

108. See, e.g., *ECONOMIC ANALYSIS II*, *supra* note 7, at 399-405.

109. *Id.* at 401.

110. *Id.* at 400.

111. See, e.g., *id.* at 179-81, 399-400.

112. *Id.* at 399.

113. See Coase, *supra* note 18.

In his discussion of property at common law, Posner poses the following problem to prepare the reader for the analysis of the Coase Theorem:

If a railroad is to enjoy the exclusive use of its right of way, it must be permitted to emit sparks without legal limitation. The value of its property will be impaired otherwise. But if it is permitted to emit engine sparks, the value of adjacent farmland will be impaired because of the fire hazard created by the sparks. Is the emission of sparks an incident of the railroad's property right or an invasion of the farmer's? Does anything turn on the answer? Suppose that the right to emit sparks, by enabling the railroad to dispense with costly spark-arresting equipment, would increase the value of its property by \$100 but reduce the value of the farmer's property by \$50 because it would prevent him from growing crops close to the tracks.<sup>114</sup>

In assuming that the railroad and farmer can freely bargain over the conflicting use of the common resource and that the cost of bargaining is negligible, Posner concludes:

If the farmer has a legal right to be free from engine sparks, the railroad presumably will offer to pay, and the farmer will accept, compensation for the surrender of his right. Since the right to prevent spark emissions is worth only \$50 to the farmer but imposes costs on the railroad of \$100, a sale of the farmer's right at any price between \$50 and \$100 will make both parties better off. If instead of the farmer's having a right to be free from sparks the railroad has a legal right to emit sparks, no transaction will occur. The farmer will not pay more than \$50 for the railroad's right and the railroad will not accept less than \$100. Thus, whichever way the legal right is assigned, the result, in terms of resource use, is the same: the railroad emits sparks and the farmer moves his crops.<sup>115</sup>

As Posner observes, the engine spark problem demonstrates that "[t]he efficient value-maximizing accommodation of the conflict will be adopted whichever party is granted the legal right to exclude interference by the other."<sup>116</sup> That conclusion is an important attribute of the Coase Theorem. Thus in its most basic form, the Theorem provides that, under certain limited conditions, individuals will bargain their way to an efficient allocation and use of resources regardless of rights and liabilities under the law.<sup>117</sup>

To appreciate the significance of the Coasian analysis of the engine spark problem it may be helpful to consider the economic theory from

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114. ECONOMIC ANALYSIS II, *supra* note 7, at 34-35.

115. *Id.* at 35. As Posner illustrates in the text, the principle is not affected by reversing the numbers. *Id.*

116. *Id.* (footnote omitted).

117. As Coase recognized, the legal outcome would have a one-time effect of transferring wealth to the party who is assigned the right to engage in economic activity. See Coase, *supra* note 18, at 5. As Posner notes, this one-time transfer of wealth may affect the actual use of resources by altering the demand for various goods and services and may even determine how the initial market assignment is made if the right in question represents a large fraction of the wealth of either party. ECONOMIC ANALYSIS II, *supra* note 7, at 35-36 n.1.

which it emerged. The thrust of Coase's analysis in *The Problem of Social Cost* was addressed to the problem of "externalities" in the theory of welfare economics.<sup>118</sup> An externality is the spillover effect of an activity that imposes cost or benefits on others without their consent. Thus, an externality will exist whenever "some activity of party A imposes a cost or confers a benefit on party B for which party A is not charged or compensated by (through) the price system."<sup>119</sup>

The engine spark case, like the standard nuisance problem of the factory that pollutes the air or water in the course of its operations, is the economist's classic example of an externality with a harmful spillover effect. The property damage caused by engine sparks is a cost that is not incurred by the railroad owner as a private cost of operating the railroad.<sup>120</sup> The continued operation of the railroad will impose harmful consequences on neighborhood property, but the price system does not charge the railroad owner for the cost of these consequences.<sup>121</sup>

The existence of externalities has troubled economists because externalities have been viewed as a source of inefficiency in the private market activities of individuals and firms. Since the spillover effect of an externality normally is not reflected in market prices or costs, it was traditionally thought that private maximizing behavior would fail to take account of the total "social" cost of all resources that are actually affected by an economic activity.<sup>122</sup> The fear was that either too much or too little would be produced and that the resulting market allocation of resources would be Pareto inefficient. A railroad owner's objective, for example, is to maximize profits that represent the difference between the total cost of production and the total revenue generated by railroad fares as determined by market prices and costs. Since the private cost of operating the railroad would not include the value of property damaged by engine sparks, private and social cost would diverge, and thus the maximizing behavior of the railroad owner would fail to utilize scarce resources in a Pareto efficient manner.

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118. For an excellent introduction to the problem of externalities in the theory of welfare economics, see D. DEWEY, *supra* note 73, at 221-28; J. HIRSHLEIFER, *supra* note 52, at 449-51; D. WHITCOMB, EXTERNALITIES AND WELFARE (1972).

119. D. DEWEY, *supra* note 73, at 221.

120. The private cost of production would include only "the part of total cost that falls directly upon the producer." *Id.*

121. There are many legal problems that can be analyzed by the externality concept. The standard negligence case involving an automobile accident, for example, can be viewed as an externality problem. The personal and property damage caused by a negligent accident is the spillover effect of driving. In the absence of liability rules, the effect of the externality is to shift the cost of negligent driving to others. See, e.g., Steiner, *Economics, Morality and the Law of Torts*, 26 U. TORONTO L.J. 227 (1976).

122. Social cost is the "true" total cost of producing a commodity, i.e. the value of all resources devoted to its production. . . . Thus [it] is the sum of (i) private cost and (ii) costs that fall on persons other than the producer (usually his workers and the general public)." In the engine spark case, total social cost would equal (1) the private cost of operating the railroad and (2) the cost of property damage caused by engine sparks. See generally D. DEWEY, *supra* note 73, at 221.

In treating externalities as an example of "market failure,"<sup>123</sup> economists who followed the traditional analysis of the English economist A. C. Pigou generally concluded that the way to prevent inefficiency in resource allocation would be to manipulate the legal system to make those responsible for harmful interfering activity bear the cost of spillover consequences.<sup>124</sup> Pigou's underlying logic was that the gap between private and social cost should be closed by internalizing the costs of externalities into the decision to pursue the offending activity. In the engine spark case, for example, this analysis would suggest that it would be desirable to make the railroad owner liable for the damages caused by the emission of engine sparks.<sup>125</sup>

What Coase did in *The Problem of Social Cost* was to uncover an apparent oversight in the logic of the Pigouvian analysis by demonstrating that, under certain circumstances, legal rules would have no effect on resource allocation, and that the market would achieve Pareto efficiency regardless of the spillover effects of externalities. Coase demonstrated that in a "smoothly functioning economy" with full information, and zero transaction costs,<sup>126</sup> individuals would bargain their way to a Pareto efficient allocation of resources regardless of where the law determined rights and liabilities.<sup>127</sup> If, for example, a railroad owner is initially assigned a right to emit engine sparks at will and the sparks adversely affect neighboring property owners, the property owners will have an interest in offering the railroad owner a bribe to refrain from exercising the right to emit sparks or, alternatively, to adopt spark avoidance measures.<sup>128</sup> If, on the other hand, the property owners have a right to be free from the adverse effects of engine sparks, the railroad owner will have an interest in offering

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123. For a general discussion of the situations in which markets fail, see Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351 (1958).

124. See A. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932). It was the conventional theory and analysis of Pigouvian welfare economics that Coase challenged in *The Problem of Social Cost*.

125. Alternatively, this analysis suggests that a tax should be imposed on the railroad owner varying with the amount of sparks produced and equivalent to the damage caused. An alternative would be to exclude the railroad owner from operating its engines near farming land when there is a strong likelihood that emission of sparks would have harmful effects. See Coase, *supra* note 18, at 1.

126. "[T]ransaction costs are all the costs which inhibit comparative markets from working." Polinsky, *supra* note 15, at 1667 & n. 67 (citing K. ARROW, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation*, in JOINT ECONOMIC COMM. 91ST CONG., 1ST SESS., *THE ANALYSIS AND EVALUATION OF PUBLIC EXPENDITURES: THE PPB SYSTEM* 47-49 (1969)).

127. The logic of Coase's Theorem is based on the opportunity cost concept of economics. See generally notes 87-88 and accompanying text *supra*. Thus, if legal rights are marketable, the parties responsible for harmful externalities will take into account the opportunity cost of not bargaining with the affected parties. Under the assumptions of the Coase Theorem, it is the opportunity to strike a bargain that serves to bring the cost of the externality into the private market calculations of the responsible parties. See D. DEWEY *supra* note 73, at 223-27.

128. It would be in the interest of the property owners to pay the railroad owners an amount up to the loss they would otherwise suffer as a result of the engine sparks. It would be in the railroad owner's interest to accept that payment if the amount offered exceeds the cost of either foregone profits or spark avoidance measures. If the loss due to spark damage is less than those costs, then no bargain will be struck and the loss will fall where it lies—on the property owners. In either case, resources will be shifted to those uses that are Pareto efficient.



compensation in order to maintain railroad operations.<sup>129</sup> In either case the bargain that is ultimately reached will be based on the total cost of the activity in question, and resources will be allocated efficiently.

Coase's analysis of the nuisance problem suggests that in a "smoothly functioning economy" there is no need for judges to be concerned about the economic consequences of their decisions. No matter where liability is placed, private market negotiations will ensure that property rights<sup>130</sup> are utilized in an economically efficient manner. Indeed, the Coase Theorem suggests that losses should fall where they lie. To attempt to alter the market outcome would merely be an exercise in futility and, in any event, the judicial shifting of losses would itself only impose additional costs.<sup>131</sup> In the Coasian world without friction, law is simplicity itself.

While the Coase Theorem suggests that liability rules have no effect on efficiency, in the real world the rule of liability does matter.<sup>132</sup> As Coase recognized, there are simply too many imperfections in markets to permit parties to bargain effectively. When the assumptions of the Coase Theorem are not satisfied, which is typically the case, the rule of liability will determine whether property rights are utilized in an economically efficient manner. This will occur when the cost of bargaining is prohibitively high, when the requisite information is imperfect or expensive to obtain, when there are too many parties to make bargaining feasible, or when it is not possible to exclude nonpaying users or "free riders" from the benefits of a bargain.

Posner also recognizes that in most cases the rule of liability will be relevant to determination of the economic efficient outcome.<sup>133</sup> For Posner, the ultimate question is one of determining what the market would do if private bargaining were feasible and if the logic of Coase's Theorem were applicable.<sup>134</sup> Since Coase's Theorem assumes that transaction costs are zero, Posner argues that the law should be structured to reduce transaction costs where they exist in order for the Theorem to work. When it is not possible to reduce transaction costs, Posner argues that the law should be designed to "approximate" the Coasian outcome by

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129. Alternatively, the railroad owner will agree to adopt spark avoidance measures rather than pay damages to property owners if the former is less costly than the latter.

130. A property right means the right to exploit or utilize a scarce resource that is subject to market exchange. For a review of the economic concept of property rights in the literature, see H. MANNE, *THE ECONOMICS OF LEGAL RELATIONSHIPS* (1975).

131. Steiner, *supra* note 121, at 232.

132. See Demsetz, *When Does the Rule of Liability Matter?* 1 J. LEGAL STUD. 13 (1972).

133. ECONOMIC ANALYSIS II, *supra* note 7, at 36-39. Posner thus recognizes that it does not follow the initial assignment of rights is immaterial from an economic standpoint. Since transactions are not costless, efficiency is promoted by assigning the legal right to the party who would buy it . . . were it assigned initially to the other party. Moreover, . . . transaction costs are sometimes so high as to make transactions impracticable. In such a case the initial assignment of rights is final.

*Id.* at 36.

134. See *id.*

providing "incentives for value-maximizing conduct."<sup>135</sup> To Posner, in other words, the law should be designed to approximate the value-maximizing solution that would be generated by market forces in the frictionless world of the Coase Theorem.<sup>136</sup>

In the case of the engine spark problem, for example, Posner recognizes that transaction costs may be so high that the railroad and farmer may fail to shift the initial placement of liability through private negotiation.<sup>137</sup> In such a case, the rule of liability will determine whether the assignment of the property right is efficient. While Posner recognizes that the search for the perfect market solution may incur significant administrative costs and require a comparison of an infinite number of possible assignments of rights,<sup>138</sup> he nonetheless argues that in most cases the value-maximizing solution can be approximated. Posner outlines the nature of the problem as follows:

Our engine-spark example was grossly over-simplified in that it permitted only two property right assignments, a right to emit sparks and a right to be free from sparks. If administrative costs are disregarded, the combined value of the farmer's and the railroad's property might actually be maximized by a more complex definition of property rights, such as one that permitted the farmer to grow one kind of crop but not another, to plant nothing within 200 feet of the tracks, and to have no wooden buildings within 250 feet of the tracks, while permitting the railroad to emit sparks only up to a specified level. The possible combinations are endless, and it is unrealistic to expect courts to discover the optimum one. But in most cases, and without excessive cost, they may be able to approximate the optimum definition of

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135. *Id.* at 68. Posner illustrates this economic test with a hypothetical situation: Suppose I sell wool to a garment manufacturer, neither of us inspects, the wool turns out to have a latent defect, and the dresses he makes out of the wool I sold him are ruined. Assume that the cost of inspection by either of us would be lower than the cost of the damage, discounted by the probability that the wool would have a defect. The manufacturer sues me for breach of contract. The central legal issue in the case is which of us had a duty to inspect. The answer depends, as to an economist it should depend, on the relative costs of inspection. If it is cheaper for him to inspect, his suit will fail in order to encourage him in his future dealings and others in similar situations to inspect; that is the solution that minimizes the sum of inspection and damage costs.

*Id.*

136. In reviewing the first edition of *Economic Analysis of Law*, Professor Polinsky summarized Posner's methodological approach as follows:

If transaction costs are zero the structure of the law does not matter because efficiency will result in any case. If the market does not yield efficient results because of high transaction costs, design the law to minimize these costs. If the market still does not work, design the law to "mimic" the market. Compensation is not important except insofar as it is required to achieve efficiency.

Polinsky, *supra* note 15, at 1665 (footnotes omitted). Posner maintains this methodological approach in the second edition without substantial revision.

137. *ECONOMIC ANALYSIS II*, *supra* note 7, at 68.

138. As Posner now explains:

Unfortunately, the solution of assigning the property right to the party to whom it is more valuable is incomplete as an economic solution both because it ignores the costs of administering the property rights system, which might be lower under an alternative definition of rights, and because it is difficult to apply in practice.

*ECONOMIC ANALYSIS II*, *supra* note 7, at 36 (footnote omitted). While recognizing that the economic solution may be incomplete, he nevertheless concludes that the law can at least approximate that solution. *Id.* at 36-37.

property rights, and these approximations may guide resource use more efficiently than would a random assignment of property rights.<sup>139</sup>

Posner argues that the efficient outcome can be approximated in most cases by determining whether the economic value created by assigning the property right to one party exceeds the loss of value to the party claiming a conflicting use. The fundamental strategy seeks to identify the rule that maximizes the net gain in value. To support his argument that the analysis is workable in most cases, Posner cites a number of common-law doctrines as examples of how the courts have implicitly applied the principle in practice.<sup>140</sup> Thus, for example, Posner discusses the common-law doctrine of "distant views":

At common law, if a landowner built in such a way as to block his neighbor's windows, he was considered to have infringed the neighbor's property rights. Observe the consequences if the property right had been given to the other party. Ordinarily the cost to this person whose windows were blocked would exceed the cost to the other person of setting back his wall slightly, so the former would buy the right. The assignment of the right to him in the first instance avoids the transaction and its attendant costs. But the courts did not extend the rule to protect distant views. If I had a house on a hill with a beautiful prospect, and you built a house that ruined the prospect, I would not be able to establish an invasion of my property rights even though the value of my property had indeed fallen. Here the presumption of relative values is reversed. A house with a view commands a large land area. The values that would be created by development of such an area are likely to exceed the loss of value to the owner whose view is impaired.<sup>141</sup>

As an alternative to his "approximation principle," Posner argues that the efficient outcome can be attained through the law by minimizing the cost of bargaining. Indeed, Posner argues that a number of common-law rules can be viewed in terms of this goal. In his discussion of contract rights and remedies,<sup>142</sup> for example, Posner suggests that many contract doctrines are explainable as efforts "to reduce the complexity and hence cost of transactions by supplying a set of normal terms that, in the absence of a law of contracts, the parties would have to negotiate expressly."<sup>143</sup> A second economic function of contract law "is to furnish prospective transacting parties with information concerning the many contingencies that may defeat the exchange, and hence to assist them in planning their exchange sensibly."<sup>144</sup> By reducing the cost of contract bargaining,

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139. ECONOMIC ANALYSIS II, *supra* note 7, at 36-37. See also Posner, *Strict Liability: A Comment*, 2 J. LEGAL STUD. 205 (1973).

140. *E.g.*, ECONOMIC ANALYSIS II, *supra* note 7, at 37-39.

141. *Id.* at 37.

142. *Id.* at 65-100.

143. *Id.* at 69.

144. *Id.*

Posner suggests that the law makes Coase's market outcome more likely and thereby encourages value-maximizing behavior.<sup>145</sup>

In surveying the major common-law fields, Posner employs this analysis to develop an economic interpretation of the common law. According to Posner, "[t]he common law method is to allocate responsibilities between people engaged in interacting activities in such a way as to maximize the joint value, or, what amounts to the same thing, minimize the joint costs of the activities."<sup>146</sup> In short, Posner's view is that the common law promotes efficiency in resource use by allocating legal responsibilities in a manner that would serve to bring about the perfect market outcome under the Coase Theorem. Posner's methodological theme is thus based on the belief that the market analysis of the Coase Theorem can be used to discern the fundamental unity of the common law. That theme also provides a normative basis for evaluating legal doctrine. Where efficiency has not been attained in practice, Posner argues that the law should be restructured in accordance with the logic of the Coase Theorem.

### III. THE ROLE OF ASSUMPTIONS AND THE UNDERLYING NORMATIVE PERSPECTIVE

Both the Coase Theorem and Posner's methodological approach assume that the economic problem of externalities can be *solved* in the real world by designing the law to stimulate what market negotiation would accomplish in a world in which there are no obstacles to bargaining.<sup>147</sup> An

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145. Posner emphasizes a third economic function of contract law—that of maintaining appropriate incentives. *Id.* at 65-69. Here the economic test is whether the imposition of contract liability "will create incentives for value-maximizing conduct in the future." *Id.* at 68. See notes 133-36 and accompanying text *supra*.

146. *Id.* at 179. While Posner has persuasively suggested that the common law promotes economically efficient outcomes, he nevertheless has failed to provide an equally persuasive reason for why this is so. Posner's overall explanation for the apparent efficiency of the common law is based on a theory of judicial motivation. In the first edition, for example, Posner argues that the common law promotes efficient outcomes because judges tended to favor such outcomes in order to enhance their own opportunities for "higher office, judicial or political." *ECONOMIC ANALYSIS I, supra* note 7, at 325. For a criticism of this view, see Leff, *supra* note 15, at 470-73; Krier, *supra* note 15, at 1693-97. In the second edition, Posner discounts this view and now apparently believes that judges have simply preferred efficient rules and that they have merely imposed "their preferences, tastes and values, etc., on society." *ECONOMIC ANALYSIS II, supra* note 7, at 416. Posner's theory of judicial motivation is reminiscent of the skepticism of American Legal Realism and its now discredited preoccupation with explaining causes of decisions in terms of psychological motivation. See, e.g., J. FRANK, *LAW AND THE MODERN MIND* (1931); Adler, *Legal Certainty*, in *Law and the Modern Mind: A Symposium*, 31 COLUM. L. REV. 91 (1931). The problem with all motivational arguments is that they fail to offer a principled rationale for understanding the process of legal reasoning. Motivation and reasoning are different concepts. See Hughes, *Rules, Policy and Decision Making*, 77 YALE L.J. 411, 425-28 (1968). Although other commentators have recently offered an alternative explanation for the apparent efficiency of the common law, see Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Rubin, *Why is the Common Law Efficient?* 7 J. LEGAL STUD. 51 (1977), their theories raise essential empirical questions but do not provide supporting proof. See also Goodman, *An Economic Theory of the Evolution of the Common Law*, 7 J. LEGAL STUD. 393 (1978).

147. In the real world high transactions costs may prevent private bargaining. In such a case,

initial problem, of course, is the exceedingly difficult empirical task of determining the perfect market outcome for any particular case.<sup>148</sup> However, even if a rough approximation of the perfect market outcome could be made, as Posner assumes, there are still other problems to worry about. For example, Professor Polinsky has demonstrated that the perfect market solution may not exist or, perhaps more importantly, it may not lead to a socially appealing result.<sup>149</sup> The problem is that there are a number of assumptions that must be made in applying the economic theory embraced by Posner's book. While it would be a mistake to conclude that the underlying assumptions of economics render the analysis useless, it is important, at least for law students, to know what can and cannot be accomplished by the theory that Posner has applied.

Indeed, one important criticism of the first edition of *Economic Analysis of Law* is that it is based on the unsupported belief that the theoretical assumptions of market behavior are useful for legal analysis. In reviewing the first edition, for example, Professor Arthur Leff warned the reader that

it must immediately be noted, and never forgotten, that [Posner's] basic propositions are really not empirical propositions at all. They are all generated by "reflection" on an "assumption" about choice under scarcity and rational maximization. While Posner states that "there is abundant evidence that theories derived from those assumptions have considerable power in predicting how people in fact behave," he cites none. And it is in fact unnecessary to cite any, for the propositions are not empirically fashionable at all.<sup>150</sup>

More recently, Professor Polinsky forcefully argued that Posner's first edition is "a potentially defective product" because it ignores certain fundamental assumptions of the competitive market model that are most likely to fail in the context of real world problems.<sup>151</sup> In Polinsky's view,

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both Coase and Pigou suggested that legal rules should be utilized to solve the economic problem of externalities. The important difference between the two approaches is that traditional Pigouvian analysis suggests that the law should be used to internalize the cost of external effects by making the responsible person bear those costs. Coase's analysis, on the other hand, rejects this view and suggests that liability should depend on the outcome that would be reached by private negotiation in a perfect market. See generally D. DEWEY, *supra* note 73, at 223-25; J. HIRSHLEIFER, *supra* note 52 at 451. Indeed, according to Posner's Coasian analysis, the term 'externality' is itself misleading since "if transaction costs are low the market may operate efficiently despite the presence of externalities." ECONOMIC ANALYSIS II, *supra* note 7, at 52. It is important to note, however, that not all economists have rejected the logic of Pigou's externality approach. Professors Whitcomb and Baumol, for example, have recently offered arguments and proofs in support of the Pigouvian analysis. See, e.g., D. WHITCOMB, *supra* note 118; Baumol, *On Taxation and Control of Externalities*, 62 AM. ECON. REV. 307 (1972). In fact, their work has been viewed as responsible for a "neo-pigouvian resurgence" that has offered a counter attack to the Coasian analysis applied by Posner. See Randall, *supra* note 51, at 40-46.

148. For a discussion of the empirical problems of applying the Coase Theorem to legal problems generally, see Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J. L. & ECON. 67, 70-73 (1968).

149. Polinsky, *supra* note 15, at 1669-81.

150. Leff, *supra* note 15, at 457.

151. Polinsky, *supra* note 15, at 1680-81.

the "[l]imitations of the competitive model for the analysis of the law may be organized around failures of three key assumptions—zero transaction costs, convexity, and zero redistribution costs."<sup>152</sup> In his "final assessment" of Posner's book Polinsky states:

A potentially defective product can be defective either because it is manufactured improperly or because it is misused by consumers. *Economic Analysis of Law* is likely to cause the greater damage through misuse by its readers than through any inherent defects. The competitive market paradigm, which is the basis of Posner's approach, requires a number of stringent assumptions, many of which are likely to fail in the context of the real world problems which Posner analyzes. These failures arise not only in the analysis of legal problems, but also in many other problems to which economic analysis is applied. However, the crucial assumptions are more likely to fail in those areas in which the law plays an important role. Because Posner does not make the limitations of the paradigm sufficiently explicit, readers not fully aware of them may accept his conclusions uncritically or may extrapolate his analysis to draw conclusions unwarranted in reality.<sup>153</sup>

While the second edition does not specifically address these criticisms, it indirectly provides a rebuttal. In a chapter on the nature of economic reasoning, Posner states:

No doubt the assumptions of economic theory *are* to some extent oversimplified and unrealistic as descriptions of human behavior—especially as applied to such unconventional economic "actors" as the judge, the litigant, the parent, the rapist and others. However, to criticize a theory on the ground that its assumptions are unrealistic is to commit a fundamental methodological error. Abstraction is of the essence of scientific inquiry.<sup>154</sup>

To buttress his point, Posner cites no less an authority than Milton Friedman.<sup>155</sup> Friedman, in an essay entitled *The Methodology of Positive Economics*,<sup>156</sup> defended the use of abstract theory in economic analysis by claiming that a theory must not be judged by the "realism of its assumptions," but rather by determining whether the theory sufficiently predicts or explains reality. In his view, the lack of realism in a theory's assumptions is a merit, not a demerit. To explain a class of complex phenomena a theory must necessarily abstract from reality, and its assumptions will therefore have to be "descriptively false" or "unrealistic."

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152. *Id.* at 1671. The zero transaction costs assumption implies "that consumers and producers are able to obtain perfect information about market prices and product quality at no costs, and that the process of exchange is itself costless." *Id.* at 1667. The convexity assumption "limits the structure of the consumer's preferences and of the producer's technology" and rules out the possibility that the effect of harmful interfering activity may become so excessive that it will no longer be subject to bargaining. *Id.* at 1667-68 (footnotes omitted). The zero redistribution cost assumption "states that the process of redistributing initial factor endowments among consumers is not costly in the sense that it does not distort behavior, or involve administrative cost." *Id.* at 1668 (footnotes omitted). For an examination of these assumptions in the context of legal analysis, see *id.* at 1671-80.

153. *Id.* at 1680 (footnote omitted).

154. ECONOMIC ANALYSIS II, *supra* note 7, at 12-13 (footnote omitted).

155. *Id.* at 13 n.1.

156. M. FRIEDMAN, *ESSAYS IN POSITIVE ECONOMICS* 3 (1953).

Thus, according to Friedman, the assumptions of a theory should be accepted if they yield predictions that are "sufficiently good approximations for the purpose at hand."<sup>157</sup>

At first impression it would seem that Friedman's argument is intuitively sound. After all,

[a] scientific theory must select from the wealth of experience that it is trying to explain, and is therefore necessarily "unrealistic" when compared to actual conditions. Newton's law of falling bodies, for example, is unrealistic in its basic assumption that bodies fall in a vacuum, but it is still a useful theory because it predicts with sufficient though not complete accuracy the behavior of a wide variety of falling bodies in the real world.<sup>158</sup>

But while the predictive power of Newton's law can be tested by performing a controlled experiment, the predictions of the economic analysis of law cannot.<sup>159</sup> The inability to conduct a controlled experiment is not, however, a problem that concerns either Friedman or Posner. In Friedman's view, "[e]vidence cast up by experience is abundant and frequently as conclusive as that from controlled experiments . . . ."<sup>160</sup> For Posner, the predictive power of *Economic Analysis of Law* is established by observing "the behavior of criminals, prosecutors, common-law judges, and other legal system participants."<sup>161</sup>

In relying upon Friedman's essay, Posner argues that those who criticize his approach on the ground that it is based on unrealistic assumptions "commit a fundamental error." What Posner fails to tell the reader, however, is that Friedman's essay is only one side of a continuing debate on an important and controversial methodological issue in the discipline of economics.<sup>162</sup> Unfortunately, Posner has not told the readers the complete story.

Paul Samuelson, for example, has characterized Friedman's methodology as the "F-twist"—the idea that "[a] theory is vindicable if (some of) its consequences are empirically valid to a useful degree of approximation; the (empirical) unrealism of the theory 'itself,' or its 'assumptions,' is quite irrelevant to its validity and worth."<sup>163</sup> According to Samuelson it is "fundamentally wrong" to assume that "factual

157. *Id.* at 14-15.

158. *ECONOMIC ANALYSIS II*, *supra* note 7, at 13.

159. "A judicial decision is not a controlled experiment of the kind that one can make in physics or chemistry, because one cannot repeat the judicial 'experiment' with the same or varying conditions." Patterson, *The Case Method in American Legal Education: Its Origins and Objectives*, 4 J. LEGAL EDUC. 1, 4 (1951).

160. M. FRIEDMAN, *supra* note 156, at 28.

161. *ECONOMIC ANALYSIS II*, *supra* note 7, at 14.

162. For the other side of this controversy, see T. KOOPMANS, *Three Essays on the State of Economic Science* 135-150 (1957); Nagel, *Assumptions in Economic Theory*, 75 AM. ECON. ASS'N (Papers & Proceedings) 211 (1952); Samuelson, *Discussion*, 75 AM. ECON. ASS'N (Papers & Proceedings) 227, 231 (1962).

163. Samuelson, *supra* note 162, at 232.

inaccuracy even to a tolerable degree of approximation is anything but a demerit for a theory or hypothesis."<sup>164</sup> While Samuelson does not argue against the use of abstract concepts, he does claim that it is the economist's responsibility to bring the abstractions of theory into line with reality. As he sees it, the motivation for the "F-twist" springs from the Chicagoans<sup>165</sup> need to build a defense for "the perfectly competitive laissez faire model of economics, which has been under continuous attack from outside the profession for a century and from within since the monopolistic competition revolution of thirty years past," and "the 'maximization of profit' hypothesis, that mixture of truism, truth and untruth."<sup>166</sup> For Samuelson, the harm of the "F-twist" is that it will lead to the belief that the imperfections and inaccuracies of economic theory are irrelevant and will serve to deflect consideration from the important task of determining "the empirical validity that the propositions of economics do or do not possess."<sup>167</sup>

As Samuelson suggests, the methodological debate over the role of assumptions in economic theory is merely part of a larger controversy in economics concerning the model of perfect competition.<sup>168</sup> In fact, the neoclassical model of perfect competition has been under attack since the 1930s, when Edward H. Chamberlin<sup>169</sup> and Joan Robinson<sup>170</sup> demonstrated that the assumptions of the model fail to correspond to economic reality. For them, modern industrial society is more accurately characterized by monopolistic or imperfect competition—an economic state in which a small number of firms dominate the market. The significance of this controversy is that it questions the classical justification for relying upon the market to allocate scarce resources: If the assumptions of

164. *Id.* at 233.

165. It should be no great surprise that there are different "schools" of thought within the academic community of economics, and that Posner's *Economic Analysis of Law* relies upon the so-called "Chicago School." Since World War II the Economics Department at the University of Chicago has been viewed as a leading advocate of the neo-classical theory of perfect competition and a critic of governmental intervention in the market. See P. DOUGLAS, IN THE FETTERED HAND, 127-28 (1972); L. SILK, THE ECONOMISTS 62-69 (1976). With but few exceptions, Posner cites only the economics literature associated with the Chicago School. See Carrington, *supra* note 15, at 188. While the second edition has cited some of the non-Chicagoan reviewers of the first edition, the book continues to rely mainly on the literature of the "Chicago School."

166. Samuelson, *supra* note 162, at 233. In the theory of the firm, the "profit-maximization" hypothesis derives from the assumption that man is a rational maximizer of his ends in life. In drawing on the profit motive, economists have assumed that "[a]ll decision makers—consumers, entrepreneurs, and factor suppliers—are income [profit] maximizers." D. DEWEY, *supra* note 73, at 9.

167. Samuelson, *supra* note 162, at 236. Professor Koopmans, in turn, argues that this is "all the more important in a field such as economics where, as Friedman also emphasizes, the opportunities for verification of the predictions and implications derived from the postulates are scarce and the outcome of such verification often remains somewhat uncertain." T. KOOPMANS, *supra* note 162, at 140. Finally, Professor Nagel, who finds that Friedman's methodology may be valid in some cases and invalid in others, makes the same point in asking: "But what is to be said of a theory whose assumptions are ostensibly unrealistic for every domain?" Nagel, *supra* note 162, at 215.

168. L. SILK, *supra*, note 165, at 26.

169. E. CHAMBERLIN, THE THEORY OF MONOPOLIST COMPETITION (8th ed. 1962).

170. J. ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION (2d ed. 1969).



competitive markets inaccurately describe economic reality, there is reason to question whether market behavior will serve to bring about an efficient allocation of resources. Thus, while most economists agree that abstraction is necessary for constructing a theory, there is no consensus for placing reliance on the neo-classical model of perfect competition.

If economists have been unable to agree on whether the assumptions of perfect competition correspond to the reality of the market place, there is even greater reason for questioning whether those same assumptions should be applied to the nonmarket context of legal problems. To argue that Friedman's "F-twist" renders this question irrelevant is but an evasion of the problem. The "F-twist" is itself merely an argument in the continuing debate over the usefulness of neo-classical theory of perfect competition. In adopting the "F-twist" as a reason for ignoring the limiting nature of the assumptions of his analysis, Posner evades some of the more fundamental questions raised by the market approach he applies to legal problems. The danger, of course, is that Posner's *Economic Analysis of Law* will give law students the unwarranted impression that there is agreement when in fact there is controversy.

The Chicago School influence also provides a basis for understanding the normative perspective that the *Economic Analysis of Law* embraces. In the Chicago tradition, Posner's book is based on the belief that competitive markets can be relied upon to serve the public interest by generating efficient allocations of resources. Like the economists of the Chicago School, Posner is skeptical of most governmental regulations of the market. In adopting the Coase Theorem as a basis for analysis, Posner ignores externalities of production and embraces the "competitive market paradigm" favored by other Chicagoans.<sup>171</sup> In relying upon Friedman's "F-twist," Posner sets forth the classical Chicago School argument in defense of neo-classical economic theory. In short, *Economic Analysis of Law* is premised on the normative arguments that the Chicago School provides for favoring decentralization in market decision-making.<sup>172</sup>

While Posner claims in the Preface to the second edition that he has sufficiently distinguished the normative from the positive uses of economics in the study of law, he has nevertheless failed to mention that *Economic Analysis of Law* is based on the ideological orientation of the Chicago School of Economics. Nor has he advised the reader that other

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171. Although all economists have a healthy respect for the market system, it is the Chicago School that is the most critical of governmental interferences in the market. The Chicagoans have traditionally maintained their defense of the market, however, by ignoring oligopoly and production externalities—the two basic problem areas in modern price theory. See e.g., Dewey, *Antitrust and Economic Theory: An Uneasy Friendship*, 87 YALE L.J. 1516, 1517-18 (1978).

172. Those arguments are also set forth in M. FRIEDMAN, *CAPITALISM AND FREEDOM* (1962), H. SIMMONS, *supra* note 107.

relevant perspectives or schools of thought exist.<sup>173</sup> While the Chicagoan tradition in economics is to be admired, one should question whether it is proper for a law school textbook to ignore the existence of widely held contrary views and theories.<sup>174</sup> It might be, of course, that a one-sided textbook was inevitable, for the developing field of law and economics may simply be "too new, too rich in points of view, too little plowed in many areas, to enjoy the harmony and confidence in ideas upon which a broad text in the time sense depends."<sup>175</sup> But since Posner has elected to use the doctrinaire approach of a textbook, he necessarily assumed the responsibility to provide an open and complete review of both supporting and contradicting views.<sup>176</sup> Since he has not done so, the shortcomings of *Economic Analysis of Law* are serious indeed.

#### IV. CONCLUSION

The second edition of Richard A. Posner's *Economic Analysis of Law*, like the first, presents a number of serious pedagogical problems. In treating economics as a mere tool of analysis, stripped of its theory and terminology, the book necessarily requires a measure of economic sophistication for effective utilization and understanding. The problem is that most entering law students have not acquired a sufficiently sophisticated familiarity with the theoretical concepts needed for the study of law and economics.<sup>177</sup> The law teacher will therefore have a major responsibility in supplementing Posner's book in order for law students to acquire the economic sophistication it requires.

This, in turn, gives rise to the very difficult pedagogical task of reconciling the conflicting goals of legal relevance and economic sophistication. The book seeks to emphasize the legal relevance of economic analysis at the expense of other important goals of the interdisciplinary study of law and economics. At a bare minimum, law students should be

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173. For a non-Chicagoan criticism of both the Coase Theorem and the Chicago approach to the study of law and economics in general, see Samuels, *The Coase Theorem and the Study of Law and Economics*, 14 N.Y. RESOURCES J. 1 (1974).

174. *Id.* See also Randall, *supra* note 51.

175. Krier, *supra* note 15, at 1702 (footnote omitted).

176. As Professor Samuels, an economist, observes:

Law and economics deal with a complex set of deep problems with respect to which the Chicago-Coasian approach represents only one particular normative position. The study of law and economics must not have its consciousness either constricted or monopolized by casuistic theories and approaches which inhibit or normatively channel consideration of the important issues and deep problems, whatever position one personally may take on them. The study of law and economics must not become the prisoner of the ideology to end ideologies.

Samuels, *supra* note 173, at 32-33 (footnote omitted).

177. See Lovett, *Economic Analysis and Its Role in Legal Education*, 26 J. LEGAL ED. 385, 391-93 (1974). Even if it is assumed that the law students bring with them a basic understanding of the relevant economics, the law school will remain responsible for training them in the application of that knowledge to legal problems.

exposed to some of the language, concepts, theories, and history of economics in order to carry forward that learning in subsequent work.<sup>178</sup>

It is equally important, of course, that law students gain a critical awareness of the assumptions and limitations of the economic concepts and theories relevant to their study. One simply cannot assume, as Posner does, that law students will somehow mystically "discover" all they need to know about the assumptions and limitations implied in the economic analysis of law. While it is important to prevent the course in law and economics from becoming a course in economic theory, some formal instruction in the theories, assumptions and limitations of economic analysis is unavoidable.

A fundamental source of difficulty presented by Posner's book is its questionable pedagogical belief that law students can learn to discover the fundamental unity of the law by simply deducing its formal characteristics from economic theory. One may question whether the Posnerian twist to the Langdellian faith is something that should be fostered in light of modern reality. Certainly economics is relevant for the resolution of legal disputes, but there are other important factors to weigh and consider.

In approaching Posner's book the reader will need to counteract what Professor Leff has characterized as the book's "tunnel vision"; that is, the simplistic idea that economic analysis is sufficient to embrace *all* human behavior.<sup>179</sup> While Posner is correct in stating that the economic approach is "matter enough for a book,"<sup>180</sup> one can still fairly ask whether that approach should be portrayed in disregard of "its limited place among human interests at large."<sup>181</sup> It is not merely that the book fails to cite anthropological or sociological studies, but rather that a particular perspective of a particular discipline is dogmatically characterized as a universally satisfactory approach for analyzing legal phenomena.<sup>182</sup>

Another pressing problem raised by Posner's book is the way in which ideology has been disguised as mere analysis. In advocating a "market approach" to legal analysis, the book necessarily espouses the values and goals of achieving economic efficiency in resource allocation. Indeed, one aspect of the book's normative perspective is that it tends to stress the importance of certain goals and to de-emphasize others. The instrumental character of the Coasian approach to legal decision-making, for instance, emphasizes the importance of distributing rights and liabilities in

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178. In economics, like law, the mastery of a language is an essential prerequisite for understanding and applying its concepts and theories. The problem facing the law teacher is to make that language intelligible. For a recent and largely successful attempt at making at least some of the elementary concepts of economics intelligible, see L. SILK, *ECONOMICS IN PLAIN ENGLISH* (1978).

179. Leff, *supra* note 15, at 451, 472-74.

180. *ECONOMIC ANALYSIS II*, *supra* note 7, at xviii.

181. F. KNIGHT, *supra* note 83, at 3, *quoted* in Polinsky, *supra* note 15, at 1658.

182. In this respect, it may be wise for those who use Posner's book to keep in mind a bit of wisdom from Professor Grant Gilmore: "The function of the lawyer is to preserve a skeptical relativism in a society hell-bent for absolutes." G. GILMORE, *supra* note 8, at 110.

a manner that would bring about an efficient allocation of resources: Questions of corrective justice, however, are either ignored or placed in the background.<sup>183</sup> While Posner initially concedes that *Economic Analysis of Law* may serve normatively as a "source of criticism and reform,"<sup>184</sup> there is the danger that law students may accept the recommendatory force of the book's approach without critically examining the value judgments laden in the analysis. When students seek the extra-legal guidance of economics in their law study, the pretense of positive analysis must be abandoned. Students need to know the critical value choices that are implicitly embraced by economic analysis in order to meaningfully evaluate the usefulness of the analysis for real world problems. After all, as Holmes has warned, the law can be civilized only to the extent it knows what it is doing.<sup>185</sup>

Perhaps the most serious problem raised by Posner's book is the way in which it views the legal system. By advocating a market approach, Posner implies that judges should be encouraged to explicitly utilize the instrumental criteria of economic analysis in common-law decision-making. While reasonable persons can differ on the wisdom of Posner's market approach, there is still the fundamental question whether this approach is compatible with the nature and function of our legal system. As Professor Buchanan has asked, "[b]ut is it not 'bad law' to suggest that the judge be guided in his decision-making by criteria other than those offered in the existing institutional setting that he confronts?"<sup>186</sup> More fundamentally, do we want law students to perceive judges as having the power to consciously engineer economically efficient legal outcomes at the expense of other equally important social interests?<sup>187</sup> To expect that judges should design the law for the specific purpose of achieving economic

183. See Baker, *supra* note 15; Tribe, *Policy Science: Analysis or Ideology?*, 2 PHILOSOPHY & PUB. AFF. 66, 86-90 (1972).

184. ECONOMIC ANALYSIS II, *supra* note 7, at 17.

185. As Holmes explained:

I cannot but believe that if the training of lawyers led them habitually to consider more definitely and explicitly the social advantage on which the rule they lay down must be justified, they sometimes would hesitate where now they are confident, and see that really they were taking sides upon debatable and often burning questions.

Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 468 (1897).

186. Buchanan, *supra* note 15, at 489. The prevailing notion in Anglo-American jurisprudential thought is that judges are not ordinarily supposed to disregard authoritative legal standards nor are they supposed to decide cases on the basis of non-legal standards unless expressly directed to do so. The underlying idea is that "[i]n countless litigations, the law is so clear that judges have no discretion. They have the right to legislate within gaps, but often there are no gaps." B. CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 129 (1921). Furthermore, even in those cases in which judges may be without the guidance of explicit standards for decision, it has been argued that the institutional setting in which judging occurs places additional limits on what judges can refer to in decision-making. See R. DWORKIN, *TAKING RIGHTS SERIOUSLY* 81-130 (1977).

187. The nature and scope of the judicial function raises a number of questions concerning the application of the instrumental analysis of economics in decision-making. There are, for example,

efficiency is perhaps a fundamental misconception of the function of a judge. To argue that the law should be designed to promote economic efficiency is politics, not science.<sup>188</sup>

The foregoing criticism does not mean that Posner's book is without redemption or that the economic approach to law study is without value. Most if not all of the pedagogical dangers of the book may be reduced once their source is recognized. Law students can be given supplementary materials and instructions on the economic theory that is relevant to Posner's market approach. Explicit attention can be drawn to the underlying assumptions, limitations and values of the analysis. Instead of seeking to cover the whole range of the legal experience, the legal area surveyed can be limited so that more time can be devoted to mastering the economics of the analysis. At the very minimum, one should at least take the time to understand the values and politics of *Economic Analysis of Law* so that the instrumental ends of the analysis can be critically examined.

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"characteristically judicial virtues" that potentially constrain judges in fashioning legal decisions. H. L. A. Hart has described these constraining virtues as "impartiality and neutrality in surveying the alternatives, consideration for the interest of all who will be affected and a concern that some acceptable general principle be deployed as a reasoned basis for decision." H. HART, *THE CONCEPT OF LAW* 200 (1961). Professors Wechsler and Henry Hart, Jr., have, in turn, argued that judicial authority rests on "principle neutrality" or "reasoned principle." See Hart, *Foreward to The Time Chart of the Justices*, 73 HARV. L. REV. 84 (1959); Wechsler, *Toward Neutral Principles of Constitutional Law*, 73 HARV. L. REV. 1 (1959). The thrust of their argument is that judges should be constrained from interjecting too much ideology into the process of decision-making at the expense of consistency and principled reasoning. While judges may be required to make difficult choices between conflicting values, they should make those choices in a fair and impartial manner by applying *neutral* principles.

188. See generally Dewey, *The Economic Theory of Antitrust: Science or Religion?*, 50 VA. L. REV. 413, 434 (1964).